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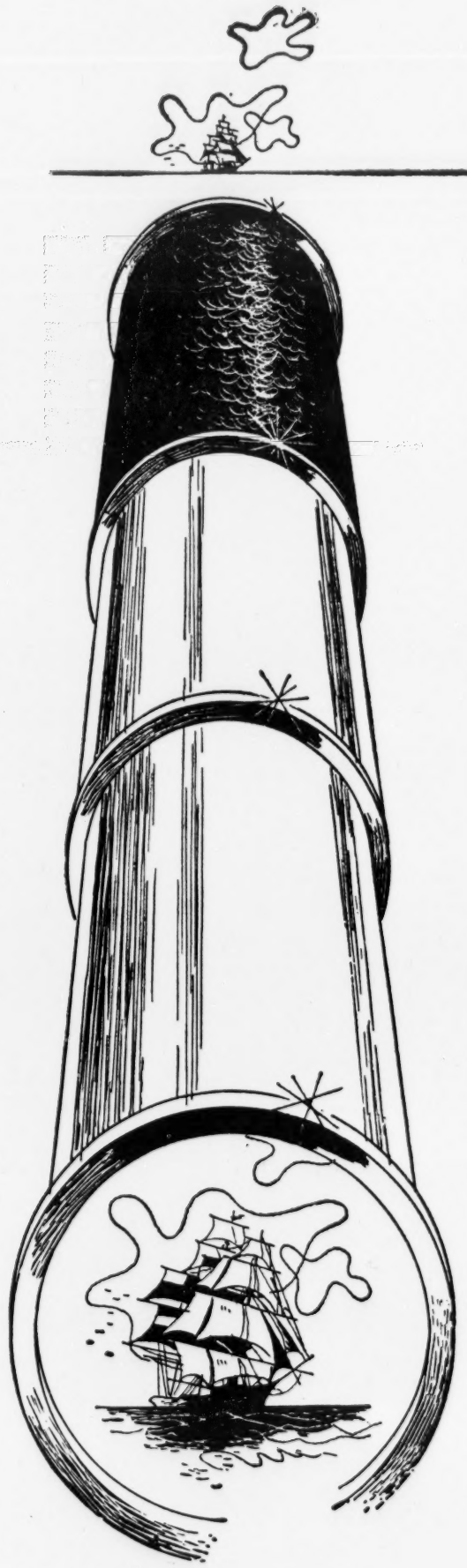

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THE
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VOLUME XXV FALL
NUMBER 3 1960

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Rape of the Fair County

"The effects of (air pollution) are fatal sooner or later for no negligible number of unfortunate people" (Ontario Select Committee on Air Pollution and Smoke Control).

"Together, the two (Kansas City, Mo., and Kansas City, Kan.) contribute a formidable volume of untreated human, kitchen, and industrial wastes to both the Missouri River and its tributary, the Kansas. Soap suds foam up frequently where creeks flow into them. Vapors rise. Below the packinghouses on the Kansas, the water turns dull red at times, and occasionally embryo calves bob with the current." (*Business Week,* July 16, 1960).

"Damage from city smog extends much further into the countryside than scientists believed likely a few years ago. A study of air pollution in southern Ontario by three experts backs up this new appraisal of smog damage. They speculate that 'tobacco weather fleck', causing an average of $1 million damage annually to southern Ontario's tobacco crop, may be caused by the smoke and fumes spilled from industrial plants and motor vehicles in cities 60 to 100 miles away." (*The Financial Post,* June 18, 1960).

"H. A. Belyea, Chief Air Pollution Control Officer for Metropolitan Toronto, says damage, irrespective of health, is now estimated at $40 for each man, woman and child, or a total of $60 million in the metropolitan area". (*The Financial Post,* August 13, 1960).

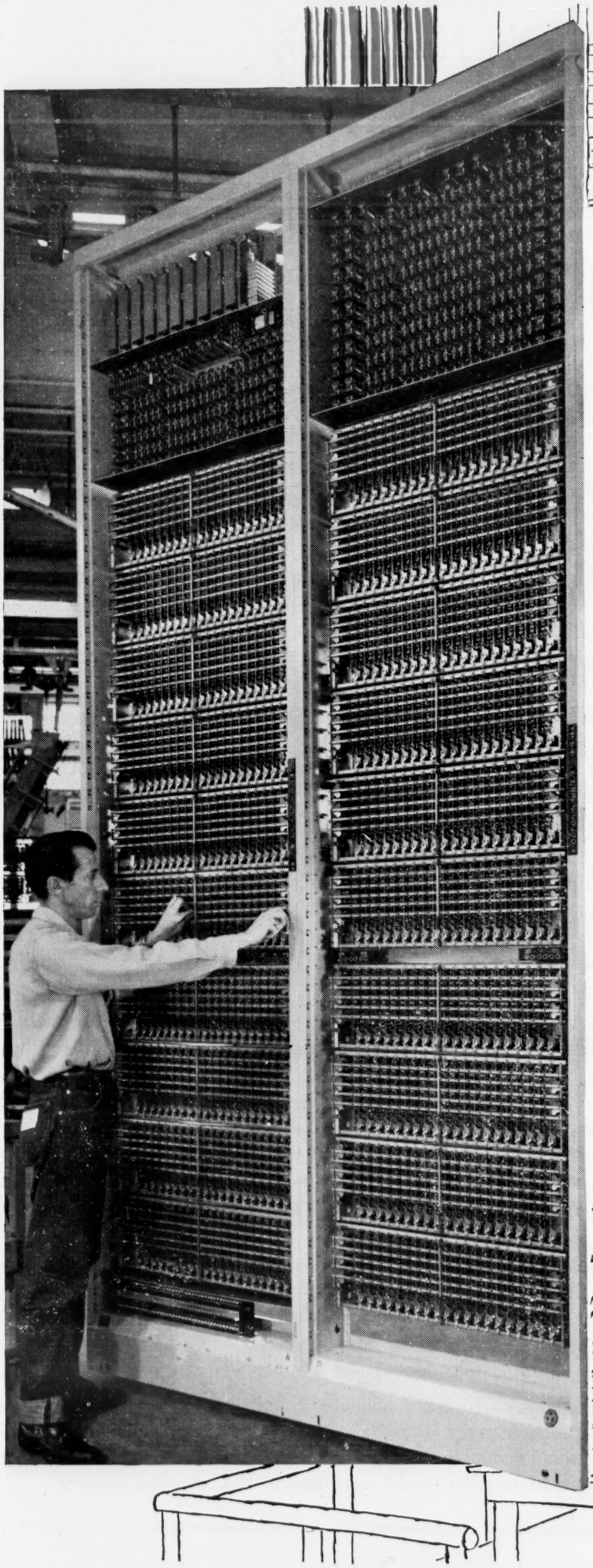
These and other recent reports give signs that a major showdown is shaping up in Canada over the reckless and irresponsible misuse of our precious natural resources of air and water. After years of government foot-dragging it now appears likely that concrete action may be taken to clear up the mess.

The Financial Post, in its excellent recent report, "Is Our Poisoned Air Killing You", quotes unnamed air pollution authorities to the effect that what we need are stronger laws and stricter enforcement of the laws already on the books. "If people holler loud enough and get their complaints in to the elected legislators, they will get action", one such authority said.

What a sorry commentary on the sense of social responsibility of our modern businessmen! Things have come to a pretty pass indeed when our business leaders, among others, have given tacit or overt approval to the killing of the fish in our streams, the pollution of our swimming-places, and the conversion of our once-beautiful rivers into stinking sewage drains. The water and the air around us surely belong to all of us, and the defiling of these national assets is, or should be, a most serious offence against our society.

Yet we must wait until "people holler loud enough". Where is business leadership? The fact is our leadership in conservation has been bankrupt. Let us hear no more about tariff protection, quotas, and "creeping socialism" until we have set our own house in order!

It may not be too late. Leadership is what is wanted—responsible leadership that thinks beyond the end of a dollar bill and possesses at least a modicum of social conscience. Surely here is an opportunity for organizations such as the Canadian Chamber of Commerce, The Canadian Manufacturers Association and others to make a constructive and substantial contribution to the betterment of Canadian Society.



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About Our Authors

R. M. Robinson is a graduate of the University of Toronto with a Bachelor of Science degree in 1935. He is Vice President and General Manager of the Electronic Equipment and Tube Department of Canadian General Electric Company Limited, in Toronto. Mr. Robinson is immediate past president of the Electronic Industries Association of Canada. Earlier this year Mr. Robinson spent some time in Japan studying that country's economic development and visiting many of its industrial plants.

W. G. Leonard is Professor of Commerce at Queen's University, in Kingston. He is a partner in the firm of England, Leonard, Macpherson & Company and secretary of the Institute of Chartered Accountants of Ontario. Mr. Leonard is a co-author of the textbook, *Canadian Accounting Practice* and the author of *Canadian Income Tax For Accountants.* He is also co-author of two books soon to be released, *Theory and Practice of Canadian Accounting* and *Municipal Accounting in Ontario.*

Lloyd I. Barber is a graduate of the University of Saskatchewan with a Bachelor of Arts in 1953 and Bachelor of Commerce in 1954. He took up graduate work at the University of California, where he qualified for a M.B.A. in Marketing in 1955. Serving on the staff of the University of Saskatchewan as Assistant Professor in Administration, Professor Barber is also employed by Muir Barber Limited during the

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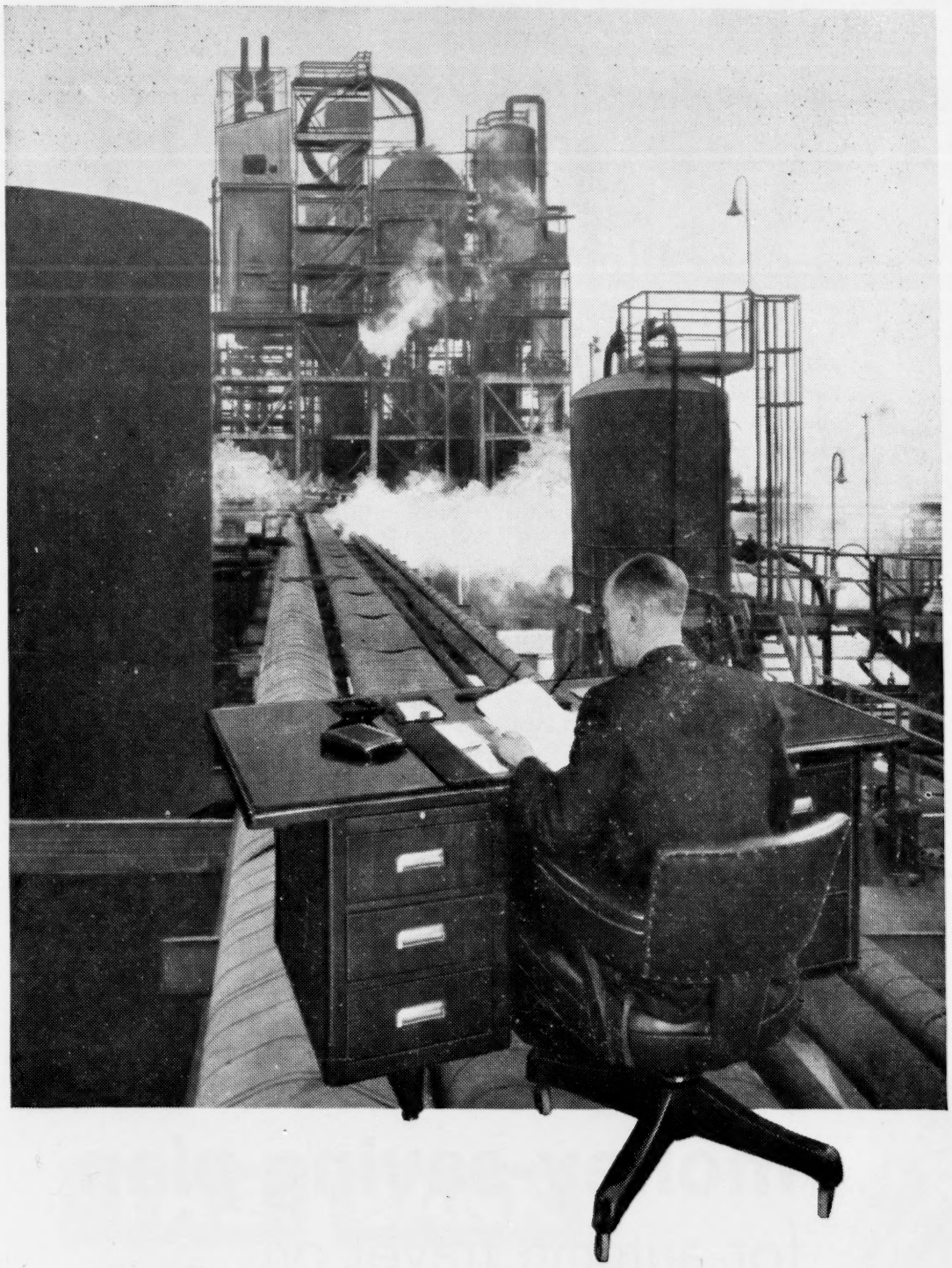

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About Our Authors cont.

summers and prior to attending university.

John A. Sarjeant is a member of the staff of The School of Business, University of Toronto. A graduate engineer, Prof. Sarjeant received his M. Comm. from the University of Toronto and spent a number of years in industrial engineering work in industry. He joined the Toronto faculty in 1958.

E. D. L. Miller attended public school and high school in London and graduated with a B.A. Degree in Honours Business Administration in 1941 from the University of Western Ontario. He joined the Huron & Erie - Canada Trust Company in 1946 and after spending two years with the Head Office Investment Department held positions of Estates Officer and Trust Officer at the Company's branch office in Windsor. Mr. Miller became Supervisor of Trust Securities at Head Office in London in 1955, and in 1958 was appointed to present position of Manager, Investment Department.

John G. Myers, B.S.F., M.B.A. received his undergraduate degree at the University of British Columbia and his M.B.A. from the University of Western Ontario, where he was instructor in International Business Management. He spent the past summer in Cairo, Egypt, where he was on the staff of an International Management School. At the present time Mr. Myers is working towards a Ph.D. at Northwestern University, Evanston, Illinois.

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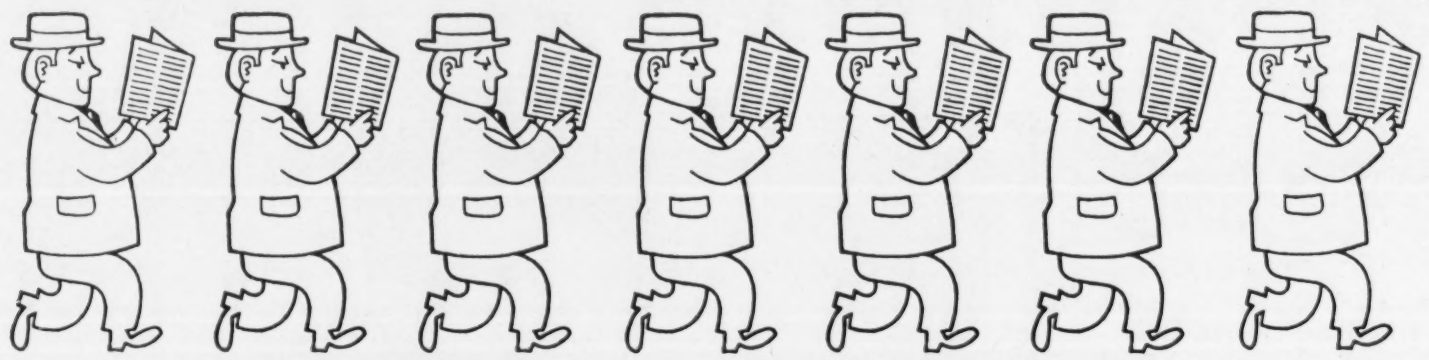
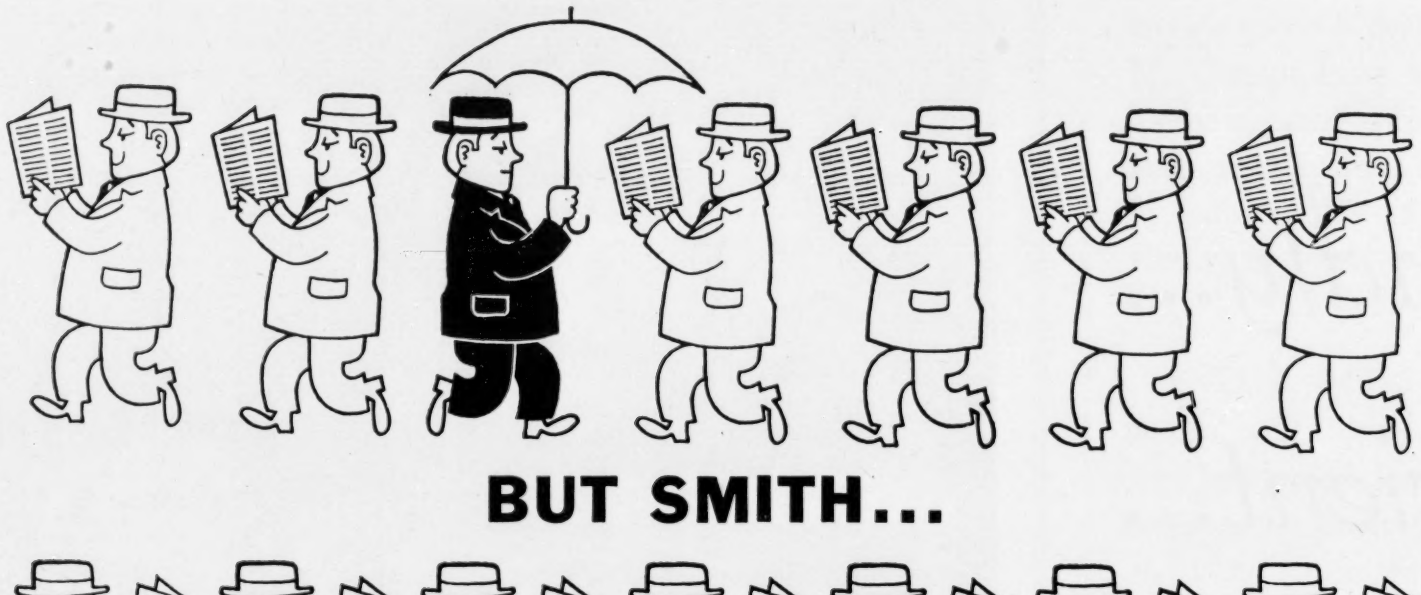
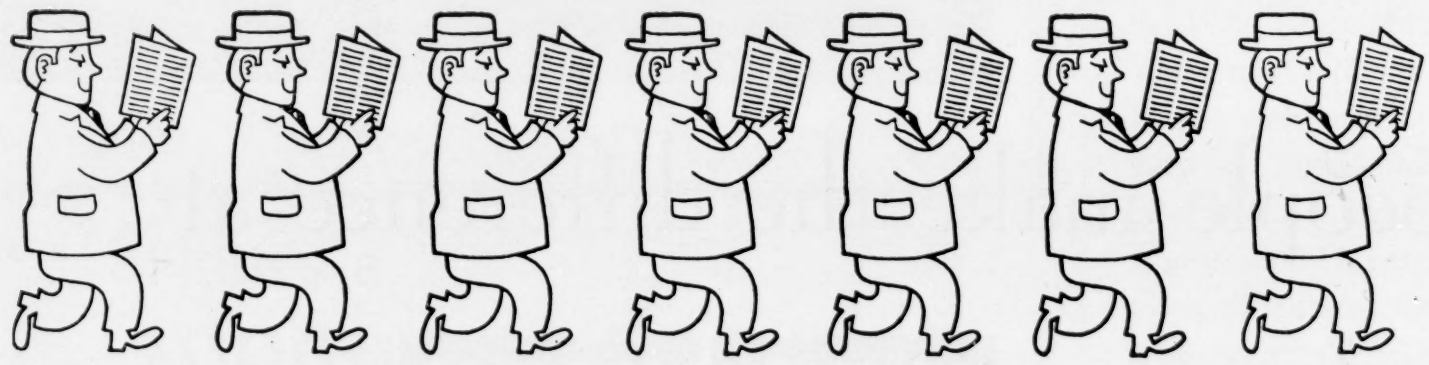


THEY'RE ALL OUT OF STEP



BUT SMITH...



That's according to Smith, of course. Actually it's Smith who's 'way out of step—all the others know the value of reading the B of M Business Review from cover to cover. This concise monthly spotlight on the business scene is invaluable in keeping you abreast of Canadian economic affairs.

Make it a point to read it every month. There's a personal copy available for you—even if your name *is* Smith—at the Business Development Department. Drop us a line or give us a call today.

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Ottawa Letter

PATRICK NICHOLSON

Our Federal Government has taken positive and effective steps to curb the competition of low-cost Japanese imports, at the request of some Canadian manufacturers.

To date the 17,800,000 Canadian consumers, being unorganized, have not expressed to the Government their disquiet at this restriction of their freedom of choice of goods which would permit their less potent dollar to increase its authority.

Representatives of the textile, rubber goods, plywood, radio, leather footwear and table flatware industries have been prominent among those who have lobbied the Government to curb Japanese imports.

Under the terms of the General Agreement on Tariffs and Trade, which we vaunt as the keystone of our trading policy, we are unable to impose quotas against Japanese goods. However our Minister of Finance, Hon. Donald Fleming, has arrived at the traditional position of old Tory protectionists by another route: he has persuaded the Japanese to curb their exports voluntarily to limits which he has prescribed.

Early in May, Mr. Fleming told Parliament of the results of negotiations which he had initiated last October. Japan had "voluntarily" applied quotas covering the export to Canada of goods which might injure or threaten to injure the Canadian producers of such or like products.

Japan was obviously and understandably not happy about this, and took pains to point out that these "self-restraining" measures as now negotiated apply for this calendar year only. Further, Japan rightly demanded that the Canadian Government should take steps to ensure that third countries should not benefit from the uncompetitive position in the Canadian market created by this partial withdrawal of Japan.

Japan's imposition of quotas on her exports to Canada obviously does not contravene the letter of GATT; but it is questionable whether Canada has not infringed the spirit of GATT in requesting that Japan should "voluntarily" take this action.

Significantly, these negotiations were carried on by Finance Minister Fleming and not, as might have been expected, by Trade Minister Gordon Churchill. Fleming, coming from Toronto, thinks first of our manufacturers; Churchill, a Manitoban, generally has the interests of the prairie wheat-grower at heart.

This angle is reflected in the fact that by far our most important export to Japan is wheat, accounting for half our dollar earnings from that country. Japan is switching from rice to bread as a staple food; last year she bought 40,000,000 bushels of wheat from us, importing a like amount from other producers, and growing approximately the same amount herself. If Japanese were to consume as much wheat as Canadians individually, and if Japan could earn the necessary dollars by selling more goods to us, we might be able to quadruple our exports of wheat to her, which raises the attractive prospect of Saskatchewan becoming the breadbasket of Japan.

Representatives of the Japanese Government have told me some revealing facts about our trade with our best non-Commonwealth friend in Asia:

Japan is the third best customer for our exports, ranking after the U.S.A. and U.K. Our imports from Japan, however, although increased eightfold in the past decade, total only 73% of the dollar value of our exports to her.

Japan's exports to Canada are widely diversified over 500 lines. Some 50 of these are new since last year (such as playing cards at nine cents per pack, contrasted to 300 times as many imported from U.S.A. at 35 cents per pack). Over 60 lines have been discontinued since last year. In only three lines did imports exceed $1,000,000 in the first three months of this year, namely plywood, oilfield equipment and garments of synthetic fibre.

Some rubber footwear manufacturers have themselves been the largest importers of Japanese products similar to those which they manufactured themselves previously.

It is relevant to note that our Government has curbed imports from Japan, although we enjoyed a trading surplus with that country last year. In contrast, no steps have been taken to curb imports from the U.S.A., with whom we had a trading deficit of $40 per Canadian which we could ill support.

Washington Letter

J. M. MINIFIE

SIX TO FIVE ON YOUR CHOICE

The economic hurricane warnings have been posted: steel is producing at about half capacity, the number of jobless rose unseasonably, and the stock market has gone to pieces. Furthermore, the Cold War is still with us. This takes care of both items in the Republican campaign slogan: Peace and Prosperity. For weeks past the experts have been debating whether the big blow will hit this year or wait until 1961, or like other whimsical hurricanes, shear off altogether and blow itself out harmlessly. The test will probably come when the new cars are presented to the public. The makers closed down early to retool for new models, hoping that demand would firm up. President Eisenhower told his press conference that six million models made this look like a good year. Sen. Kennedy retorted that the industry had produced over seven millions in the past, and that if this was good, he did not want to be around when things were poor.

As usual, the American slump has rubbed off on Canada, and promises to do so more intensively. American investments, on the basis of forward intentions, will be lower, reflecting the softness of raw materials. Sen. Kennedy had a cure for lead and zinc miners which would not have been much to Canadian taste. He told a meeting in Idaho that he would not have vetoed, as the President did, the bill which would have subsidized uneconomic American mines. This would have exported the depression to Canada, Mexico and Peru.

These are exhausted mines for the most part. The number of unemployed involved is not large—far fewer than the increase in Toronto's jobless in August—and the basic solution is rehabilitation, not subsidy. Yet for this relatively negligible vote, Sen. Kennedy was ready to pass the load on to the United States' neighbors. It gives an insight into the Democratic champion's economic reactions which offers little for the neighbors to cheer about.

Vice-President Nixon has been telling sceptical labor throngs that they never had it so good. But they are too close to reality to be convinced. At this point, if the elections were held now, the majority of Democrats voting the straight party ticket would probably put Sen. Kennedy into the White House. It does not follow that this will hold on Nov. 8. For some time now the betting has been six to five either way. The voter is as uncertain as the economy. Polls revealed an unusual proportion undecided.

This indecision has been in part responsible for the prominence taken by the religious issue. Disliking or distrusting both candidates, the voter has clutched at an emotional crutch: fidelity or antipathy to the Roman Catholic Church. Sen. Kennedy met the issue head on. His statements have been direct and masterful; and in fact he would probably be less prone to be swayed by his churchmen than most Protestant presidents have been by theirs. The suspicion is taking root that Sen. Kennedy, if elected, will be less prone to be swayed by cleric or layman than any president in recent times. But in that respect Mr. Nixon differs little. Either promises to be a "strong" president. Six to five on your pick.

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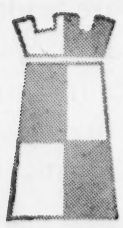

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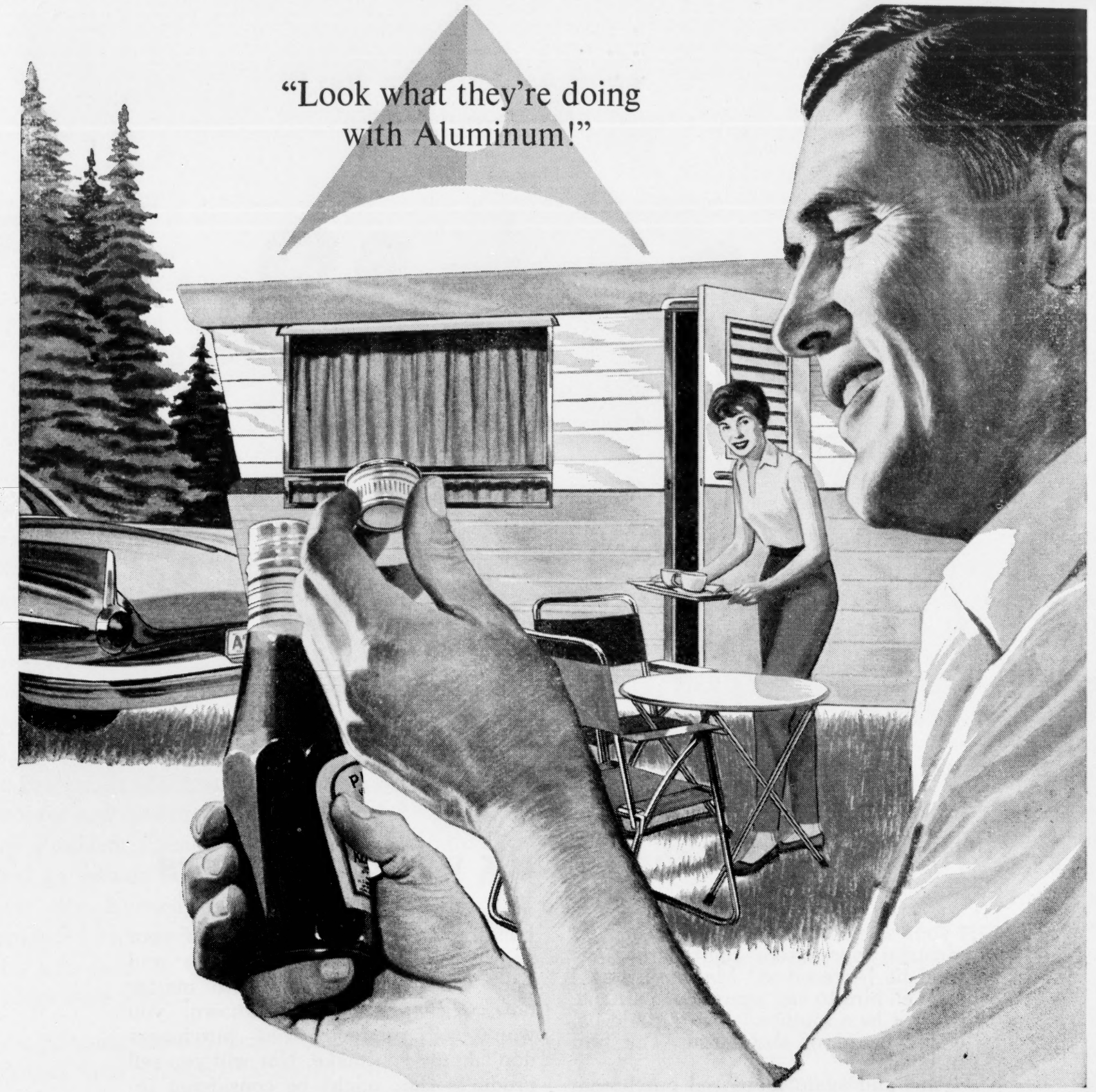

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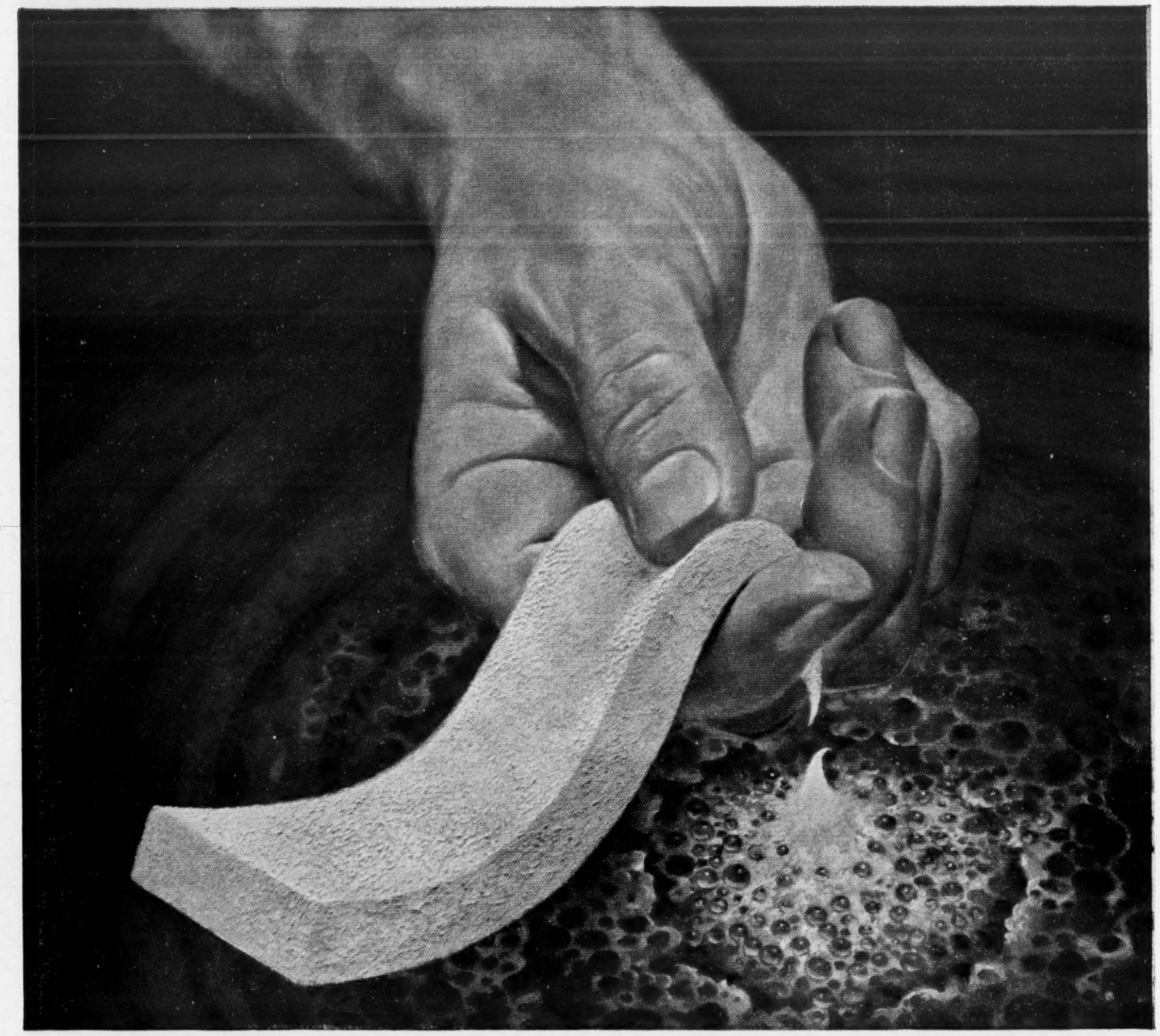

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Is Our Secondary Industry Threatened by Japan?

A number of Canada's secondary industries today are facing increasing competition from imports. Particularly prominent in the trading picture have been low-priced Japanese imports. The author, vice-president of Canadian General Electric, examines the impact of this competition and the forces behind it.

R. M. Robinson

Do rising levels of imports pose a serious threat to Canadian secondary manufacturers? Has the steady inflationary spiral priced Canadian manufactured goods out of the domestic market as well as the export market?

The answer to these questions provides plenty of food for thought—and for controversy. Published comments reflect this, with one group stressing the serious damage caused to Canadian business by imports, and another equally vociferous group advocating increased purchases abroad to aid Canada's overall trade.

To typify this controversy we need only examine recent statements from responsible Canadian organizations. The Electronic Industries Association of Canada, in a recent bulletin, said:

> "On the basis of 1961 forecasts of Japanese imports, unless effectively curbed, the radios imported will represent 4,194,000 man hours of productive labour, or 2,097 jobs lost to the Canadian electronic industry in 1961."

By contrast, the representatives of three prairie wheat pools and the United Grain Growers Limited, in a letter to Prime Minister Diefenbaker, said they

> "strongly urge that measures should not be used to perpetuate types of production in Canada which have no prospect of competing with Japan at normal levels of tariff protection. Everyone who is interested in Western Canada must be seized with the importance of the Japanese market to the prairie economy."

Obviously there must be an optimum position somewhere between these two conflicting views. As in all such contentious problems, due consideration must be given to both sides being affected before drastic changes are justified.

Understandably, deep concern has been registered by those segments of industry hardest hit by imports. These segments fear that the plague which has hit them with such lightning rapidity will sweep over all of Canada's secondary industry, rendering production facilities idle and creating mass unemployment.

It would be proper and timely to mention one product line which currently is causing its fair share of deep concern. Electronic tubes is the product involved, and is a good example, typical of our manufacturing industry. It could well serve as an indicator of what will happen to other product lines as well.

BRIEF HISTORY OF CANADIAN TUBE INDUSTRY

In the past 20 years, the number of employees in all manufacturing plants across Canada has increased 100%. There are now more people employed in manufacturing than in the combined industries of farming, fishing, mining, forestry and construction. Manufacturing now provides 1-1/3 million jobs. The spectacular growth of manufacturing has played a major role in advancing our standard of living.

Electronics, a relatively new technology, advanced much more than industry as a whole, increasing sevenfold between 1946 and 1955. The greatest impetus was the introduction of television and rising levels of defence work which has electronics at its

heart. The total number of production workers grew to over 25,000 by 1955. While such phenomenal growth could not continue indefinitely at this rate, it was fully anticipated that there would be a steady increase because of the many new electronic products finding their way into daily use. Now, five years later, employment has dropped to less than 19,000 and large layoffs are still in process in the industry.

There are several factors which have contributed to the decline. Television production has dropped from a peak of nearly 800,000 units annually to less than 400,000 units because of market saturation. The development and production of defence electronics in Canada has been drastically curtailed because of our reliance on the United States, and defence production sharing has not replaced this market to date. But these were only regarded as temporary setbacks and the upward climb, it was felt, would be resumed because of increasing use of automation, computers and other applications of electronics in industry.

The biggest single factor which has suddenly entered the picture, and for which there is no apparent remedy within the industry's control, is importation. To be more specific, let us look at electronic tubes. The first tube manufacturing unit was established in Canada in 1921. There are now five main manufacturers which employed in 1955 over 3,000 people. Production included tubes for entertainment receivers and such miscellaneous types as reliable tubes for industrial and military use, cathode ray and a small number of solid state devices. Canadian production rose to over 16,000,000 tubes. An additional 8,000,000 to 10,000,000 were also imported, mainly from the U.S. These were newer types with small volumes. As soon as the volume of a type had grown sufficiently, with tariff protection and lower labour rates than the U.S., Canadian manufacture was begun. This was a relatively healthy condition at this stage. The high developmental costs had been paid for, and the reliability and use of the particular type had become established. Future growth always seemed to be beneficial to us. The bigger the volume, the better Canadian costs became, and these types were no longer imported.

Transistors have been able to replace some of the types of tubes, and a logical growth opportunity for the tube manufacturers would have been to manufacture transistors along with other solid state devices. But complete transistorized radios are now being imported from Japan, with the level of these imports jumping from 69,000 units in 1957 to 395,000 in 1959. Assuming that these sets would use an average of six transistors each, imports account for over 2,000,000 transistors. This quantity would have justified Canadian production, but there is now no economic justification for producing these types. This means that other types required for industrial purposes, such as automation, computers, controls, etc., will have higher unit costs.

Tube manufacturing requires precision workmanship and a great deal of experience in order to get reliability of performance. Large investments of capital are required for precision machines, jigs and tools. The labour content is large so that costs are greatly affected by labour rates. It is far from a fly-by-night business into which a new competitor can suddenly make a spectacular entry. It had all the characteristics of being a good, solid business for many years to come. Yet suddenly it is threatened with extinction. Employment has dropped to less than 2,000 and is slipping fast. From a reasonably profitable position the industry is now showing an operating loss.

An analysis of the figures in the accompanying table ("Canadian Imports") will show clearly the cause of the downfall.

On examining these figures, the obvious question arises "Why is so much furore being raised about $678,000 worth of tubes from Japan when those imported from the U.S. are 10 times as great?" There are several good reasons why the smaller amount from Japan has created such violent reaction.

Canada's buying habits have been questionable for a long time. This country imports manufactured goods at the rate of $262 per capita annually. This compares with $27 imported by the U.S. and $50 by the United Kingdom. Only about 2% of our manufactured imports come from Japan, just as tube imports from Japan seem insignificant in relation to tube imports from the U.S. A major factor which must favour more imports from Japan is our balance of trade. Imports from Japan at approximately $100 million are 35% less than our exports to that country. The differences in buying from Japan, as compared say to buying from the U.S., are as follows:

a) The tubes were originally designed and developed in the U.S. Developmental costs were high and vast amounts of money were spent in research work, not only on the product itself, but in developing a market for it. A similar development would not have been economically possible with Canada's small population.

b) As a similar Canadian market was created due to our interchange of people and advertising material, Canadian manufacturers were able to select the component with sufficient volume to justify tooling up in

TABLE I

CANADIAN IMPORTS — RADIO TUBES

(Source: Dominion Bureau of Statistics)

	Full Year 1956			Full Year 1957		
	Units	Dollars	$/U	Units	Dollars	$/U
RADIO TUBES (6166)						
United Kingdom	29,250	191,628	.65	72,319	110,086	1.52
Germany West	1,162	605	.52	4,846	1,983	.41
Japan	—	—		210	639	3.04
Netherlands	598,895	219,487	.36	725,028	314,353	.42
United States	7,953,927	8,479,633	1.06	5,604,226	6,051,550	1.08
All other	5,201	3,204	.62	3,371	16,405	4.87
TOTAL	8,588,435	8,894,557	1.03	6,410,000	6,495,016	1.01
	Full Year 1958			Full Year 1959		
RADIO TUBES (6166)						
United Kingdom	178,696	151,436	.85	336,755	420,112	1.25
Germany West	14,417	6,747	.47	2,516	9,983	3.97
Japan	212,962	66,640	.31	2,205,140	678,317	.31
Netherlands	981,344	334,256	.34	911,221	386,653	.42
United States	6,357,736	6,782,966	1.07	5,691,534	6,270,060	1.10
All other	15,464	58,919	3.81	10,487	62,089	5.92
TOTAL	7,760,619	7,400,964	.95	9,157,653	7,827,214	.85

Note: Preliminary DBS figures show Japanese tube imports increased 258% in 1960's first quarter over the like period in 1959. If this increase continues, total Japanese tube imports in 1960 will be 45% of production of Canadian-produced types.

Canada. Even though the volume would still only be in the neighborhood of 5% or 6% of U.S. production, with our labour rates 20% to 30% lower and tariff protection we could sell Canadian production at lower than imported prices. In other words, large as the importations were, we knew they would ultimately result in a market justifying Canadian production.

c) The importers of tubes were usually Canadian tube manufacturers. Being in the business, they were in a good position to recognize the proper point on the volume curve to enter manufacturing.

d) The types being imported from Japan are those with large volumes for which investment in tooling has already been made in Canada. With labour rates so low in comparison with ours, the tariff protection is inadequate and Canadian production cannot compete. The fair market value of 31c for Japanese tubes is less than one-half of Canadian factory cost.

e) Many of the importers are not tube manufacturers and so first-hand knowledge of the market is becoming cloudy.

f) U.S. imports were gradually becoming a smaller percentage of our total market, whereas the Japanese percentage has increased at a phenomenal rate. Japanese methods of manufacture are equivalent to or better than ours. With large volumes and good equipment, quality products can be turned out with a minimum of waste effort and material. With a genuine desire on the part of Japanese workers to increase productivity, output per operator is high. Industrial rates have increased, but even now the Japanese worker only earns in one day approximately the amount an equivalent Canadian employee earns in one hour.

g) In a desperate attempt to compete with these low-cost imports, prices were drastically reduced on the types produced in Canada to a point where there is no longer

any gross margin left. Any reduction in volume will further inflate costs.

The method of collecting sales and excise taxes creates a further discrimination against the manufacturer. Because of the lower market values in the foreign country, the fair market value of the tube is always lower than the Canadian factory selling price. Taxes are paid at the border and there is an accidental subsidization of imports as shown in the following table.

		Duty	Sales Tax	Excise Tax	Total Tax
Canadian Tube—					
Factory Selling Price	1.26	—	.11	.15	.26
Japanese Import—					
Fair Market Value	.31	.062	.041	.056	.097

In addition to this disadvantage to the Canadian manufacturer, it will be seen that there is a direct loss of revenue to the Government.

STANDARD OF LIVING

One possible solution frequently voiced is that Canada will be competitive again when the Japanese standard of living approaches our own. By comparison with ours, the Japanese standard of living is low. The use of electricity is on the increase, but it will be many years before ranges, air conditioners, automatic washers and driers, dishwashers and other electrical servants can be afforded, even if desired. Refrigerator saturation is less than 25%, and domestic production is limited to the small types of about 3½ cubic feet in size. Even though traffic in the larger centres is seriously congested, there are few private cars. There is a preponderance of taxis and trucks. The use of bicycles and motorcycles is very heavy. Commuting trains are also used extensively. Undoubtedly pay rates in Japan will increase, but will probably take several decades to approach ours.

Japan has relied heavily on foreign trade. In prewar years Japanese exports were mainly hand-made consumer goods and textiles. Her principal customer was China, which absorbed 37% of Japanese exports. With this market cut off, Japan has turned more to the production of iron and steel products and other manufactured goods requiring machines for production. These now account for 40% of her exports. Soil conditions are poor and will only produce 80% of the population's food requirements; the other 20% must be imported at a cost of roughly $500 million annually. In order to produce manufactured goods, Japan must also import such raw material as cotton, iron ore, lumber, etc. In order to afford these for home consumption, a percentage of her manufactured output must be exported to cover the cost of raw materials.

It is no wonder under these conditions that Japan seeks to increase her trade with Canada. In order to demonstrate the capabilities of her industry she has encouraged visitors to Japan. On a recent trip there the author had the opportunity of examining at first hand some of the factories producing electronic products and components.

EDUCATION

The educational system in Japan is being tailored towards an increase in export trade. Japan recognizes that skills in manufacturing and engineering, including development and research work, are essential to an expanding industry. The country has over 500 universities and technical colleges, with many of these giving very specialized courses. Trade schools are frequently associated with a manufacturer and located at plant sites where the students live in dormitories. These courses appear to be glorified apprenticeships; the reward for high marks is the opportunity to become technicians and engineering assistants. With a population of over 93,000,000, these skilled jobs in Japanese industry are highly regarded and competition for them on the part of the students is very keen.

The main requirement for entrance to a university is high academic standing. Students who qualify receive economic assistance. The students themselves seem to have a feverish sence of urgency, with a dedication to improving Japan's economic lot. They apply themselves with a keen interest which a visitor can easily admire.

The general educational system is divided into three segments—six years elementary, three years middle school, and three years high school. English is compulsory for the last six years and a second language, frequently French, is taught in the last three years—which should prove useful in simplifying communications with customers in the export market. Undoubtedly the Japanese language, which uses so many Chinese characters, makes communication slow and cumbersome and is not readily transmitted by typewriter, teletype and other modern machines. The new Japanese phonetic alphabet is a move to improving communication. There are typewriters with as many as 3,000 characters, but even under skilled hands these are slow and incomplete. Most letters are hand written for greater speed.

With so much emphasis being placed on technical education, and with such enthusiastic students, Japan is rapidly becoming more than just an imitator and copier of other countries' products. Just as we

have done, she copies up to a point and then improves by innovation, new techniques and increased technology.

CAPITAL

One limiting factor on Japanese industrial expansion has been lack of new capital. In the past there have been restrictions on the withdrawal of dividends from the country so that foreign investors have been limited. Regulations now permit dividends to be withdrawn, and while there is still a limitation on the percentage ownership of a company allowed to foreign investors, capital from outside the country is being encouraged.

QUALITY

Japanese reputation for quality products has been in question by some countries in the past. Japanese business concerns regard this as a matter of prime urgency. The Japanese Government established the Industrial Standardizing Law in 1949, which placed rigid regulations on quality. At present, under special legislation (The Export Inspection Law of May, 1957), some six government export inspection offices and organizations are inspecting 145 export items, which account for 50% of Japanese total exports. Every effort is being made to guarantee that the product bearing the circular J.I.S. (Japanese Seal of Quality) denotes high quality and fine workmanship.

THE FUTURE

Where do we go from here? Without Government intervention there is only one answer. If the Canadian consumer is willing to buy these products produced in other countries with such low labour rates, Canadian manufacturers have no opportunity of being competitive. With less than 18,000,000 population, Canada's total production is small. As already mentioned, any inroads made by imports will increase costs still further.

By comparison, Japanese electronics production has risen from $362,000,000 in 1957 to a staggering $936,000,000 in 1959. This means Japan will be able to afford still better production equipment, and the consequent increased volume will result in still lower costs.

Canada may be able to sell more wheat, barley, iron ore, asbestos, coal and rye whiskey to Japan, but these represent relatively few man-hours of labour. The products we are importing have probably four to five times as much labour involved per dollar of value. The dollars we are spending abroad are depriving many Canadian citizens of the opportunity to earn a living in our manufacturing industry. At a time when our gross national product appears to be so healthy, we have near-record unemployment. Unemployment insurance is relieving the situation temporarily, but how long can this continue to fill the void? It would take an unreasonable increase in tariffs to make a significant contribution, so that the only real solution at this time is probably a quota system. When imports of a particular product are allowed to increase tenfold over the previous year, it is no wonder that industry feels that the Government is either unaware of its plight or feels that its existence is not essential to the Canadian economy.

COMPETITIVE SPIRIT

Salmon bred from roe in fisheries have a rough time of it when released in tidal waters. The synthetic environment which eliminates danger also dulls the competitive instinct so necessary for survival in a cannibalistic world. The way of nature is rough and hard, whether it is hound against hare, falcon against dove, midge against elm, or crab grass against Kentucky blue.

Risk is the price of a day's adventure. Complete security is an obvious contradiction in terms, just as 100 per cent insurance against any danger or difficulty is as meaningless as it is unwarranted. Risk is an inherent quality in life, and with risk is the compensating impulse to survival which is competition.

For instance, thousands of business enterprises fail each year, with financial loss to suppliers and personal loss to proprietors. Can commercial insolvency be prevented? Not entirely. Not in a competitive economy. The right to fail is just as inherent in free enterprise as the right to succeed. Commercial failure is part of the normal wear and tear on the machinery of production and distribution. However, risk implies caution, and caution comes with understanding and experience of the hazards of "going to market." Most commercial failures are personal failures caused by a mixture of overconfidence and undertraining for the responsibility.

The business life is a spirited enterprise, and it offers exciting compensations. But daring must often outweigh caution where decisions must be made. The more we seek shelter, the more we invite mediocrity. There comes a time when we must face realities with the forthright understanding that we are on our own. No fighter ever won a championship punching a bag or shadow-boxing, and no business man can succeed or survive without exposure to competition.

—Dun's Review and Modern Industry, March, 1960.

Effects of Taxation On Business Decisions

In this paper, the author surveys the field of business taxation in Canada and finds a number of shortcomings. He points to the causes of friction and suggests where Canadian legislation might be improved. The author is Professor of Commerce at Queen's University.

W. G. LEONARD

In reviewing much of current discussion that occurs concerning the weight of the total tax burden on the Canadian tax community, one finds a large content of emotion and relatively little solid discussion or cold-blooded analysis.

It is only too easy to find newspaper writers or after-dinner speakers making emphatic statements to the following effect:

1. The level of taxes is so high as to impose an insupportable burden on the Canadian business community. This is particularly serious because we live in an open economy. We must export or wither away on the vine. Our costs must remain competitive.

2. Dire disaster is likely to strike the Canadian nation in days to come if we continue to permit the withering away of individual initiative, industrial and commercial vigour in the enervating shadow of big government. This kind of statement is usually tied in with some mention of an increase in the proportion of total taxes to total national income.

A slightly facetious version of the same sort of complaint appeared recently under the heading "Quotable Quotes" in *Reader's Digest*:

"Taxes are going up so fast that government is likely to price itself right out of the market".

However, I do not know of any published analysis which compares the Canadian tax structure with that of other countries in comparable stages of development and which demonstrates the existence of any major disadvantages which the Canadian tax structure imposes on industry and commerce as compared with the tax structure of other competing nations. Comparisons seem to be made only with some ideal standard rather than with other jurisdictions. Perhaps this is a field in which Canadian scholars might develop some useful studies.

Monteath Douglas contributed an article to *Canadian Tax Journal* of January-February 1953 at a time when federal tax rates were higher than they are now. He pointed out the difficulties of demonstrating a clear-cut relationship between high tax rates and the unfavourable consequences that often are blamed on high tax rates. He said, it would seem that, in the modern world,

1. high tax rates often go together with rapidly-rising natural production and rapidly-rising standards of living,

2. high tax rates often go together with rapidly-increasing rates of capital investment in new industry.

A. W. Gilmour stated in a paper published in the January-February 1960 issue of *Canadian Tax Journal* his opinion that—"the current Canadian Income Tax Act compares most favourably with those of other large trading countries, both as to efficiency and simplicity".

Any feeling that the over-all burden of taxation is likely to be lightened in future years must be coupled with the discovery of entirely new sources of revenue or reduction of levels of expenditure on such things as the armed forces, debt financing, social welfare, education, or roads and highways. My own personal opinion is that, in the kind of industrial economy we live in, any such expectation would be unrealistic and I quickly pass on to other areas of discussion which may show promise of greater reward for effort expended.

HOW DO WE DISTINGUISH GOOD TAXES FROM BAD TAXES?

Any discussion of the qualities of various schemes and structures of taxation seems to concern itself, at least in the introductory stages, with the basic ideas developed by Adam Smith in *Wealth of Nations* (1776) as four maxims of taxation.

1. ABILITY TO PAY

Subjects of the state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities.

2. CERTAINTY

The tax which each individual is bound to pay ought to be certain and not arbitrary.

3. CONVENIENCE

Each tax ought to be levied at the time, or in the manner in which it is most likely to be convenient to the contributor to pay it.

4. EFFICIENCY

Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.

J. R. Petrie, in his book *Taxation of Corporate Income in Canada* (1952), stated that the Canadian tax system is "in large part devoid of any rational integration. It is the result of the ever-increasing scramble for revenue by all the tax-levying bodies in the nation". He numbers the tax-levying bodies in the thousands and says that "the result is a conglomeration of taxes" and "a hodge-podge of overlapping taxes".

Petrie, in discussing equity in taxation, stated that in choosing a tax that suits our notions of equity, "Income is probably the best conceivable measure or yardstick". However, the inherent difficulties of computing income for tax purposes make it a yardstick on which we cannot read the scale.

Some writers have urged that a tax that is evident such as the income tax is superior to a tax that is half-hidden or disguised such as sales taxes or excise taxes.

One theory is that, in a democracy, taxing should be plain and open and readily understandable so that discussion among voters may be full and frank and citizens shall understand the clear-cut relationship between government spending and taxation.

On the other hand it has been urged that the art of taxation is like that of plucking a goose. The aim is to obtain a maximum of feathers with a minimum of squawking. Too great an emphasis on matters of taxation to the detriment of other significant policy decisions may produce an excessive emotional reaction from men of business. Too many business decisions may come to be made irrationally and emotionally for tax reasons in situations where tax effects—real and imagined—receive undue emphasis to the detriment of sound business reasons when, if the sound business reasons were rationally weighed and considered, the compass might be seen to point in a different direction.

PROGRESSIVE TAXES VERSUS PROPORTIONAL TAXES

Most of our taxes are related to some indication of ability to pay, such as value of land owned, volume of sales or volume of commodity purchases. However, tax theorists generally agree that the size of the yearly income of individuals is the truest indication of ability to pay. Therefore, only taxes that vary in amount with the size of yearly incomes are really equitable in the modern sense.

When the supplementary theory of *least sacrifice* is coupled with that of *ability to pay,* we arrive at the notion that only a progressive tax is truly equitable, that is a tax which, at various points above the subsistence level of yearly incomes, takes a larger and larger portion of income increments. The personal tax is the only taxing device we Canadians use that corresponds with this concept of equity in taxation.

Taxes are levied in Canada at each of three levels, municipal, provincial and federal.

For municipalities, the only big revenue producer is the tax on real estate. It is based on ability to pay as indicated by the capital value assessed on real estate which a taxpayer owns. This assessment has no direct relationship to yearly income of the owner of real estate.

Real estate taxes tend to enter into costs of doing business in two ways:

1. taxes on real estate used for business purposes are a cost of doing business, and

2. taxes on real estate used as workers' residences enter into the workers' cost of living and may influence the Canadian wage level.

In making business decisions, the kinds, effectiveness and location of municipal services are likely to be of greater significance than the amount of taxes payable.

For the provinces, the most important sources of revenues are taxes on commodities such as gasoline and liquor, other sales and consumption taxes

and revenue from the public domain derived from natural resources such as oil, gas, minerals and standing timber. In Ontario and Quebec, corporation taxes are important.

None of these taxes has any direct relationship with the size of yearly incomes of individual taxpayers.

At the federal level, three taxes are the big revenue producers, namely, corporation taxes on income, personal income taxes and the sales tax.

The corporate income tax is a proportional levy with modifications for incomes smaller than $25,000 which make it slightly progressive for total incomes. However, there is no clear-cut or close relationship between corporate income taxes and the yearly incomes of individual shareholders.

Personal income taxes at the federal level are our only progressive levy based on the level of yearly incomes of individual taxpayers.

Sales tax levies vary in amount with volume of business transacted. Some pressure is taken off the subsistence level of Canadian workers by the exemption of cost-of-living components such as foodstuffs. Additional consideration is given to the minimization of business costs in the granting of exemptions for various categories of producers' goods.

A. K. Eaton in a paper entitled *Problems of Tax Policy* delivered at an Income Tax Seminar at Queen's University in 1957 argued that

"Good ways of raising revenue are awfully scarce" and that when a government develops a tried and true method of taxation, that method of taxation is here to stay, regardless of theoretical considerations. He also argued that our public welfare expenditures such as family allowances, old age pensions, and veterans' pensions are an offset to any failure to develop a greater degree of progression in our tax system.

I have not seen any passage that is more in accord with my own opinions and prejudices than the following portion of the report of the Rowell-Sirois Commission:

> The personal income tax is the most highly developed modern instrument of taxation. It can be more delicately adjusted to individual circumstances, and thus made fairer in its incidence, than any other tax. It adjust itself automatically to economic fluctuations. It can raise a given revenue with less burden on the national economy than any other tax because it is drawn from surplus income rather than made a burden on costs.

Another passage in the Rowell-Sirois report reads:

> The income tax is collected directly and relatively cheaply, with no hidden costs and waste. And it has become an integral part of modern economic, political and social policy. It is the most effective method yet devised, within the framework of the capitalist economy, for achieving the social and humanitarian objectives of our civilization; for applying wealth which is made possible only by organized society for the benefit of society as a whole; for preserving the freedom of individual initiative and at the same time making possible the financing of those services which can be most economically provided by the community as a whole.

Perhaps, as some of our businessmen feel, it may be time for newer and better analyses to be developed, based on criteria that are more objective, understandable and usable. If new analyses are there to be found, I submit that scholars in the field of business should be assiduous in searching for them, digging them up and putting them through any refining process that may be necessary to permit them to stand up to possible attack.

However, one additional point should be made clear concerning our present income tax system. I think that even though the theory of a graduated rate structure may be excellent, it was unnecessary to go crazy with the pattern of graduation and to build up a series of seemingly-insoluble problems such as we now have. For example, why create such a difference as now exists between:

1. the tax effect of accumulating corporate incomes and,

2. the tax effect of distributing corporate incomes?

To-day no sane capitalist will ever bring himself to distribute accumulations of corporate surplus in a straightforward manner if he can help it because of this crazy, built-in differential inherent on our tax law.

In 1960 the top personal bracket carried a rate of 80% for taxable incomes exceeding $400,000. In my opinion an 80% marginal rate is too high—if only for psychological reasons.

In my opinion, if we wish to maximize tax efficiency and tax yield, our top bracket should never carry a rate much higher than 50%.

Also our law should recognize, to a greater extent than now, that lump-sum distributions of surplus earned in other years should be taxed at average rates which recognize that these do not represent earnings of a single year.

A SPECIAL PROBLEM

Not only does the income tax on yearly incomes of individuals come closest of all our taxes to satisfying our theories of equity but, of all our taxes, the federal income tax is the biggest earner of revenues for governments.

Hence, anything that interferes with the efficiency or fairness of this tax is of major concern both to governments and taxpayers. I think that one important defect of its application in Canada is the lack of a clear-cut co-ordination of the corporate income tax with the individual income tax. A special problem relates to the profits which a corporation retains in its business. The corporation has paid its flat rate tax, but personal income tax is postponed until the year of distribution. Undistributed and untaxed income piles up beneath the serene gaze of the corporate executive, the anxious and hungry eyes of the shareholder investor, and the icy stare of the tax administration.

I am not going to go into minute detail concerning undistributed incomes of corporations, designated surpluses and special rules relating to personal corporations. The special rules are numerous and complicated. Piecemeal amendments to the Income Tax Act have been enacted year by year on a hand-to-mouth basis as the administration grimly plugs particular loop-holes which the ingenuity of taxpayers and their advisors had revealed to the anxious gaze of the tax administrators. It has been a merry game of trying to slam shut the stable door each time it becomes evident that a few horses have been stolen and that some taxpayers have found still another way to take out large chunks of undistributed income free of personal income tax.

One reason I am not going to go into detail is that the details are too complicated to be readily explainable. Another and more important reason is that we would be dealing with symptoms and not with the disease.

In my view, no permanent solution is possible until clear-cut choice is made as between two alternative philosophies of corporate taxation, namely:

1. A corporation is a separate person in law and should be taxed on the same basis as any individual person. If we adopt this theory, the well-worn phrase "double taxation" become meaningless.

2. The second philosophy is, in my personal view, simpler and more logical. A corporation should be taxed as an association of individual shareholders and corporate taxes should be fully integrated with taxation of the individuals who own shares in the corporations. The only hiatus should be the time interval between earnings and distributions. If corporate perplexities make personal identities uncertain, we already have a workable precedent. We tax trusts accumulating for the benefit of unascertained beneficiaries as if they were separate individuals.

Until it is decided which of these two theories is to be applied, no logical or efficient system of taxation is possible. Here, again, I quote from the report of the Rowell-Sirois Commission:

> "The primary criticism of the present system is that business has been made an object of taxation in itself".

In addition to specific taxes "which bear no relation to net profits and have naturally become fixed charges, embodied in the overhead", the commission had harsh words for

> "corporate income taxes which are not real income taxes. They apply to corporate net income at a flat rate but are not adjusted to the net income of the corporation owners at either a uniform or graduated rate".

Perhaps the Canadian tendency to use flat-rate taxes on corporations and to avoid integration with personal income taxes arises because of the large non-resident shareholdings in key industries. We apply a flat-rate tax on the corporate income and then we exact a flat tax of 15% as withholding tax deducted from dividend payments to non-residents. When so much of our tax yield comes from these sources, the attempt to achieve equity for resident individuals under some theoretically equitable system may seem to the tax administration to promise greater complexity; hence more numerous misunderstandings with our U.S. investors and possible loss of tax revenue.

I do not attempt here to summarize the analyses of economists as to whether the incidence of the flat rate corporate tax is on business costs or on shareholders. It seems to me so far to be a draw - something like an 0-0 baseball game.

DEDUCTIBILITY OF BUSINESS EXPENSES

As Petrie said in his book, the inherent difficulties of computing income for tax purposes make it a yardstick on which we cannot read the scale.

One difficulty is that the law relating to income tax is relatively new. In the border-line areas of the law, there may be a minimum of certainty. Also, what certainty there is may not "square" with the business man's ideas of equity.

A serious problem in the income tax field in Canada today relates to the question:

"What kinds of expenses may be deducted in determining the yearly incomes of business enterprises?"

Those who are interested in this question should read an article in the November-December 1959 issue of *Canadian Tax Journal* by the ex-Assistant Deputy Minister of Finance, A. K. Eaton, entitled, "Where Angels Fear to Tread". I quote the last two sentences of his article:

"Withall I am entirely convinced that what I have suggested would place our Income Tax Act on a sound logical basis and could lead . . . to a much more consistent and fairer tax law for business in Canada. There might even be less litigation."

In studying the present legislation, we run into a curious anomaly. All the authorities who speak of their day-to-day contacts with the federal tax administrators—both in Ottawa and in the field—are high in the praises of our tax administration as being honest, intelligent and humane. And so are its day-to-day interpretations of statutory rules.

However, the details of our tax law are somewhat archaic. In some places, the law paints with a broad brush in terms that may be characterized as those of sweet reasonableness: in others, the law lays down rigid formulas (or formulae!) in petty detail. In some places, the Income Tax Act plus the regulations are designed almost in the form of an assessor's manual rather than a statement of general rules.

All in all, the language of the statute as interpreted by the courts is much less reasonable and much less humane than its day-to-day administration and interpretation by the tax assessors.

Every so often, an appeal will cause a judge to apply the law literally and strictly, and this causes great consternation all round—both to tax administrators and taxpayers. A great deal can be done in developing broad, general principles for up-dating the Income Tax Act while eliminating some of the detailed specifications and avoiding like the plague any future tendencies toward particularization.

To emphasize that I am not exaggerating I offer two comments from speakers at the 1959 conference of the Canadian Tax Foundation.

Gwyneth McGregor, editor, Canadian Tax Foundation stated (with regard to the law relating to personal corporations):

"When I was recently given an assignment to make a survey of the whole question, I talked to a number of practitioners—lawyers and accountants—and to officials. The existing legislation was described to me in varying terms, some unprintable; translated into standard English they would be: antiquated, obscure, inconsistent, ineffective, stupid and in some respects, downright unworkable. An official admitted that the Department had to *"make* it work", and that means, as you all know, that administrative practice does not follow the Act. The fault does not lie with the Department which seems to do a sensible job; but it should not be necessary. There should not be any legislation which is it impossible to put into practice."

Lancelot J. Smith, speaking in the same session, said:

"While this may be the legal position, it would be very surprising if the administration were to apply these provisions—(in a certain way). Nevertheless, the taxpayer should not be left in a position where he is dependent upon the administration refraining from a strict application of the law."

CONCLUSION

At the time when this paper was originally prepared, the 1960 amending act to the federal Income Tax Act had not yet appeared. It was my hope that the technical amendments which would be published by the time this paper appeared in print would erode a sizable portion of the ground on which I based this paper and, hence, would have relegated some of the problems of which I write, if not into the limbo of forgotten things, then into the category of past inconveniences which would now be only dimly remembered and which would serve future historians as peculiar guide-posts in the slow evolution of a Canadian "tradition".

An amending Act has now appeared, however no basic reforms are attempted. We must live yet another year with the slight consolation that problems related to distribution of corporate earnings are to be subjected to "comprehensive study" during the coming year, presumably by a committee of civil servants.

Retail Competition and
TRADING STAMPS

Of all the merchandising devices introduced in recent years, none has aroused as much controversy as the trading stamp. Legislation outlawing stamps has been passed in several provinces, and court actions are pending in others. In this article, the author argues that we should let the market place, not the legislators, be the judge of stamps.

L. I. BARBER

The economy of the present, while no longer adhering to principles of laissez-faire liberalism, still pays homage to competition as a device for regulating economic activity. It must be pointed out that this competition is at best imperfect but none the less operative. If we admit that competition should be allowed free play, we must carefully examine all attempts to restrict the scope of any competitive device which is not obviously dishonest, immoral, or otherwise in contravention of the public good.

The recent furore over trading stamps in this country has led to a series of legislative and legal moves in the various provinces, ranging from the restrictive legislation passed but not proclaimed in Saskatchewan to test-case prosecution under the Criminal Code in Ontario. Conflicting testimony has been heard from economists, consumers, businessmen and legislators. It is the purpose of this paper to discuss the role which trading stamps do play in retail competition, and to consider the wisdom of legislative prohibitions or restrictions in this light.

FORMS OF COMPETITION

Broadly, there are two major classes of competition that operate in the economy. The first, and more desirable kind, is price competition. In theory, if manufacturers and distributors of consumer products compete actively on a price basis, the profitability of their operations will be minimized as a result of this activity. The inefficient operator will be forced either to improve his efficiency or vacate the line of trade in which he is engaged. Price competition thus results in the most efficient production and in the lowest cost to the consumer.

The second major class of competition is non-price competition. When most units in a particular line have become nearly equal in their production costs no startling inroads into the market of competitors is possible through further price reduction. Consumers may be sensitive to a large price reduction, but tend to lose their sensitivity as the price cuts are reduced in magnitude. When this occurs, non-price factors assume far greater significance in the economic life of the enterprise. Brands are developed in an attempt to build a "safe" position for the products of one manufacturer. Advertising is purchased to extol the virtues of the brand. Location, service, and other unique features of one store or one producer are emphasized. Each institution will seek a mix of competitive factors which will tend to serve its best interests.

This phenomenon is well illustrated by the evolution of supermarket merchandising in the grocery field. The techniques developed by the supermarket merchandiser resulted in substantial gains in efficiency which were passed on to the consumer in the form of price cuts. The resulting increased volume allowed for the maintenance of profitable operations despite further significant price cuts. Clientele was attracted from those institutions that did not or could not adapt to the new techniques. An increasing number of supermarket units forced supermarket operators to effect even greater operating efficiencies. Under this kind of pressure the margin of profit per sales dollar fell to remarkably low levels. The traditional gross margin in grocery operations was in the neighborhood of 25% to 35%; supermarkets were claiming gross margins as low as

12%. The present net on sales dollars is in the neighborhood of 2% to 4%. At such narrow profit margins it becomes apparent that further significant price reductions are, at best, difficult to achieve.

The supermarket merchandiser is now forced to turn to other forms of competition in order to maintain or boost his volume so that he can continue to operate profitably. Advertising expenditures are increased in order to inform more people of his "superior" values. Desirable locations are sought with extreme care—parking lots are expanded and improved in order to attract more buyers. A wide range of services is added in order to make shopping more pleasant. The supermarket tends to lose its low-cost advantage as the costs of these services can no longer be absorbed by increasing volume.

The same kinds of evolutionary stages are apparent in the development of other types of merchandising institutions. A revolutionary idea results in the establishment of a business vastly different from its competitors. If it is successful, competitors will be forced to change in the direction of the new institution. The new institution and the competitors move toward a compromise between the revolutionary idea and the desirable aspects of the old. This phenomenon is particularly well illustrated by the development of the discount house. Merchandising techniques in the drug business illustrate similar characteristics. In a competitive economy the endless struggle for the consumer's dollar tends to result in the development of the most desirable institution.

FREEDOM AND COMPETITION

Competitive forces are such that they must be allowed free rein in order that evolution can be carried to its logical conclusion. At times excesses may develop, but by and large these excesses will be self correcting with the consumer being the ultimate beneficiary. When it appears that an excess will not correct itself because of permanent imbalance, then and only then should an attempt be made to regulate the activity in question. Even then, suggested regulation should be carefully scrutinized and should be selective in nature. Great care should be taken to insure that "the baby is not thrown out with the bath water".

This plea for the free play of competitive forces applies to both price and non-price competition. Trading stamps are nothing more nor less than a competitive device. While trading stamps fall into the non-price class of competitive devices, they exhibit more of the characteristics of price competition than do many of their relatives.

Any single merchant is faced with the task of making his outlet distinctive enough to attract and hold patronage. This distinction may be on the basis of location, store design, operator's personality, merchandise line, credit, advertising, or anything else that the operator might devise in order to set himself apart from his competitors. Trading stamps are but one of the devices that he might adopt to accomplish this task. In fact, trading stamps have proven to be a particularly powerful influence on trading patterns in some areas where they have been utilized. This explains to a significant degree their appeal to the aggressive merchant.

Evidence of the close relationship between price competition and trading stamps is provided by the experience in some American states that have "fair trade" laws. Fair trade laws allow the manufacturer to fix and enforce the price at which his product shall be sold at retail. In some cases, the giving of trading stamps with purchases has been interpreted as a violation of these fixed-price regulations. This is a further illustration of strangulation of competition.

LEGAL POSITION IN CANADA

In Canada, trading stamps occupy an unique position as a result of legislation under the federal Criminal Code. The legislation was enacted in 1905 partly as a result of pressure from the Retail Merchants Association (a group still opposed), and partly because of knowledge that unscrupulous operators were engaged in fraudulent stamp plan operations. While the situation is decidedly unclear as to the effect of this legislation, it may be worth while to offer an interpretation of the desires of the government of 1905. It would seem that the legislation was designed to prevent two quite distinct and separate activities: One was the prevention of stamps issued by stamp companies independent of the issuing merchant. There would seem to be nothing in the legislation to prevent the merchant from using premiums, giveaways, or even properly-designed stamps. It might conceivably be assumed that this legislation was designed only to thwart the fraudulent stamp operator. The second prohibition was designed to prevent infringement on the sole right of the Federal Government to issue and circulate currency. It is felt that certain kinds of trading stamps might, in fact, infringe upon this right. In contrast, it is significant to note that relatively few jurisdictions in the United States have legislated against trading stamps and that the British Parliament has seen fit to allow their continuance.

CHARGES AGAINST STAMPS

In order to assist in the formulation of definite conclusions regarding trading stamps, a discussion of some of the charges leveled at them will now be undertaken.

The first argument against trading stamps is that they add to the cost of doing business and therefore the consumer pays for the premium she gets. No one would argue but that the cost, *in toto,* of promotional activities must be returned through the prices charged for the goods. However, much of the promotional expense may be justified because of the stimulation it has on demand. If an operator can increase his volume without increasing his fixed costs, unit costs of production will be lowered. If successful, promotion can increase volume to the extent that prices can be lowered despite the cost of promotion. Be that as it may, the pertinent question here is whether trading stamps add to the cost of the goods that the consumer buys.

The best evidence seems to indicate that trading stamps cost the retailer 2% to 3% of his sales volume. Because of his low margin of net profit (2% to 4%) it would logically follow that he would be forced to increase his price to cover this cost. The logic of the situation and the practicalities are in fact quite different. Several things could happen to prevent the increase in price.

In the first place, the retailer might substitute stamps for some other promotional device now in use. He might restrict the use of other premiums. He might cut down on costly services. He might reduce his advertising expenditures, although during the introduction of the stamp plan this is unlikely.

The second way the retailer may cover the cost of the stamp plan is by increasing his volume. Authoritative estimates place the increase required to cover these costs in the neighborhood of 12%. Recorded increases in volume in stamp stores exceed this requirement by a significant margin. A survey of 19 food store companies by *Supermarket Merchandising*[1] indicates increases in volume ranging from zero to 100%. The average was in the neighborhood of 27%. Other sources have indicated increases in volume as high as 221%. If volume is increased, the cost of the stamp plan is borne by the proprietors of those stores which lose patronage.

The third way that the costs of the stamp plans may be covered is through a reduction of the profits of the store utilizing them. This could happen if competitive conditions prevented the store from raising price and volume was not increased. The proprietor would then be the victim of his own promotional scheme and would undoubtedly discontinue it.

The argument is often advanced that if all stores were to introduce stamp plans, a higher cost equilibrium level would be reached, at which point the costs would be passed on to the consumer. Complete saturation is neither a logical nor practical possibility. Retailers strive for distinctiveness. If all retailers have stamps, a merchant would no longer be distinctive because he had them. Long before the saturation point is reached an alert trader would devise some alternative method to make his wares distinctive. He might even resort to direct price cutting. In many instances the introduction of stamp plans has been met with significant price cutting by the opposition. This has produced a much more competitive market resulting in benefit to the consumer. In fact the battle lines in Saskatchewan seem to have been drawn on this basis, with non-stamp stores advertising price advantage while stamp stores were extolling the virtues of their premium plan. Evidence collected by the U.S. Department of Agriculture indicates that the consumer may receive real benefit from stamp plans.[2] A 3½ year study by this body in 21 cities, indicates that food prices in stamp-giving stores rose by six-tenths of one percent more than in non-stamp stores. Prices in non-stamp stores rose one-tenth of one percent and stamp-stores' prices increased by seven-tenths of one per cent during the period between November 1953 and March 1957. The value of premiums to the customer seems to be about 2% of purchases on which the stamps are issued. If prices rise by 0.6% and the premium value is 2%, the consumer realizes a net gain of 1.4%. The return to the consumer could range from a low of zero to a high of 3% depending upon such things as the valuation of the premium and the rate of return of the stamp plan. It seems valid to conclude that the consumer could receive a net benefit from the collection, assuming no allowance for time spent licking and sticking. Trading stamps provide some kind of a direct return to the collector, a characteristic not common to most other forms of promotional activity. In the words of *Consumer Reports,* ". . . trading stamps with which the consumer can obtain, say, a new percolator, are certainly to be preferred to hot air."[3]

MORALITY OF TRADING STAMPS

Premium stamps have been attacked by certain groups on the grounds that they are immoral; that they lead the consumer to believe that she is getting something for nothing. It has been suggested that stamp saving becomes a mania with greater attention being paid to the premium or stamp value of the article than to its price and quality. A cartoon shows a housewife objecting to a 39c a pound price for prime beefsteak because the stamp value is too low.

[1]"Industry Reviews Premium Plans", *Supermarket Merchandising,* XVIII (Aug., 1953), p. 37.

[2]United States, Bureau of Labor Statistics, *Monthly Labor Review,* March, 1959. Vol. 82, No. 3, p. 276.

[3]*Consumer Reports,* Oct., 1956, p. 508.

Cases are cited where shoppers leave change on the counter and make off gleefully clutching the trading stamps. These examples illustrate the value of stamp plans to the merchants utilizing them. However, to outlaw trading stamps because some people are guilty of excess is no different from oulawing automobile credit buying because some people are induced to buy beyond their means. The fact is that the consumer can, in the case of trading stamps, get some direct return. If the consumer feels that she is no longer receiving benefit from the stamp scheme she should be intelligent enough to decide for herself to abandon collection. It is presumptuous to assume that she must be protected against herself. She has a right to decide in the market place whether stamp plans offer the value she wants or whether she should switch her patronage to non-stamp stores. Stamps may even be of positive psychological benefit to the collector.

It must be kept in mind that the incomes of many families are such as to preclude saving out of current expenditure for desired luxuries. Trading stamps are one alternative to expensive credit buying of coveted items. Saving in advance is to be preferred to costly credit purchasing.

STAMPS AND THE SMALL MERCHANT

The argument is often advanced that trading stamps are one more weapon in the arsenal of "Big Business" which can be used to devastate the defenseless independent. In point of fact, trading stamps are one device which can be utilized effectively by the small businessman. To a significant degree the small merchant is prevented from taking advantage of advertising as a promotional device. The cost is too high per unit of sales because of the waste circulation involved. In trading stamps the independent has a device which will build store loyalty without waste cost. He pays in proportion to the business that he does and therefore is paying only in relation to the effectiveness of the trading stamp. The opposition on the part of small merchants stems from two sources: namely, a failure to understand the nature of stamps, and the fear raised by the appearance of a powerful and little-understood competitive device. It seems that we all pay lip service to competition, but when it appears to threaten our own position we adopt all types of defensive behaviour. It is worth repeating that if competition is to be an effective guiding force all types of "reasonable" competitive devices must be allowed to operate.

CONCLUSION

Stamp companies make money, of this there is no doubt, but to accuse them of parasitical money-making as has been widely charged is unjust. The money made by stamp companies comes, for the most part, from the markup on the premiums they dispense. In a sense they are but one more institution operating in the channels of distribution for these goods. The large stamp company has enormous buying power which allows it to purchase goods at substantial savings unavailable to other institutions. Competition among stamp companies should ultimately force this saving to be passed on to the consumer. If the stamp company can perform a desired service, and perform it efficiently, then why should it not make money?

On balance, it seems that more can be said in favour of trading stamps than against them. This position is taken by many observers who have made a detailed objective study of the trading stamp question. In 1933 a committee of the British Board of Trade concluded its report to Parliament in the following manner: "For the reasons set out above, we have arrived at the conclusion that both as regards gift coupons and trading stamps the practices which The Gift Coupons Bill seeks to make illegal are not detrimental to the public interest and do not call for any legislative intervention."[4]

Trading stamps are basically no different from other kinds of competitive devices. They do not threaten the fabric of society. They are not immoral or fraudulent. Their economic value, their effectiveness, their importance, should be decided in the market place, not in the legislative chambers.

[4]Board of Trade, Committee on Gift Coupons and Trading Stamps, *Report,* Presented by the President of the Board of Trade to Parliament by command of His Majesty, July 1933, London. Printed and Published by His Majesty's Stationery Office.

PROBLEMS AND PROSPECTS OF BRITISH EXPORT TRADE

The Canadian situation is difficult at the moment. To have a 6 per cent. bank rate with recovery only in its early stages is certainly a great pity. The long-term recovery of their economy is not to my mind in any doubt at all. They always manage somehow or other to turn up with some bad trick that makes trouble for the moment, but the long-term growth has been maintained and will continue to be. The difficulty is that Canada is from so many points of view part of the North American market and there is no point in trying to sell things in Canada which are strongly and competitively made in the United States. Unless you can sell something in the United States you probably cannot sell it in Canada either. In one or two cases where there are tariff advantages this is not true, but by and large you are taking in the same competition in both countries.

—W Rees-Mogg, *The Manager,* Journal of the British Institute of Management, March, 1960.

The Dynamic Nature of Job Content

Job evaluation procedures all to often are based on the assumption that the job itself is a reasonably static thing. In this paper the author argues that the content of many jobs is dynamic and changing over time. He describes the nature of some of these changes, and their implications to job evaluation.

J. A. SARJEANT

It is often argued that Job Evaluation, in spite of its limitations, provides a useful, workable and satisfactory method of establishing an equitable wage rate structure. Unfortunately, job descriptions, upon which the whole evaluation procedure depends, become obsolete shortly after they have been written. It is misleading to think of a collection of jobs as being in a static state and accurately represented by the job descriptions.

In the first place, there are many outside influences forcing changes in job content. A firm will periodically alter its products, processes, procedures, or organization structure, thus affecting a good many of the jobs, changing the requirements, and rendering obsolete the carefully-developed descriptions and job specifications. In addition, there are many changes occurring in almost every job as the incumbent gains experience. Such changes are often difficult to detect and hence pass unnoticed until employee dissatisfaction or turnover rates force recognition.

Thus the job description, like the balance sheet, is like a photograph of conditions as they existed at a point in time but which does not necessarily portray the changing nature or direction of change in the subject.

To argue that all jobs are constantly changing would be to exaggerate the case. Certainly many factory and office jobs remain fixed in content after the worker has attained a degree of experience. A significant proportion of jobs do change with time, however, and such changes are difficult to identify and hence difficult to measure.

FACTORS IN JOB EVALUATION

In the typical job evaluation scheme, jobs are assessed in terms of four basic factors. These are working conditions, effort, skill and responsibility. The job description attempts to specify the requirements of the job in each of these four factors (often broken down into as many as 12 or 14 factors, but all are variations or sub-divisions of the basic four). The changes referred to above apply in the skill and responsibility factors primarily.

WORKING CONDITIONS

Working conditions do not materially change with time; they are seldom given much weighting or importance; and in the opinion of some, they should have very little influence in the determination of the wage rate of the job. If other aspects of the job are not satisfactory or appealing, then pleasant working conditions will not attract workers. Similarly, high wages alone will not attract workers to unpleasant working conditions.

EFFORT

Effort, both physical and mental, is a difficult factor to measure because of its subjective nature. While physical work done could be measured by scientific means, the concept of mental effort is vague. What may be difficult work for one person may be simple or enjoyable for another. Thus we are restricted to measuring or gauging the continuity of mental effort—the proportion of time devoted to thinking, or the rate at which thinking or decision-making must occur. Some consideration is often given

to the diversity of mental effort as well—in how many areas of endeavour must decisions be made? But even when these attributes can be measured, should the upper or lower end of the scale be rewarded with greater compensation.

The amount or degree of mental effort required is one aspect of job content which changes with time. As the incumbent becomes more familiar with the job, he does it more quickly, and presumably with less mental effort.

In this connection it would be well to think of the distinction used by Elliott Jaques[1] between prescribed and discretionary parts of the job. All jobs contain some of each; some of the work is routine and standardized, the rest requires some judgment or choice on the part of the worker. Jaques reports that in no actual job in the course of his studies was there a complete lack of discretion, even if the only discretionary part of the job was the selection of the rate at which to work.

Mental effort is required for both prescribed and discretionary work. Following a standard instruction, for example, involves reading or remembering or both; and these activities could rightly be classed as mental effort. Similarly, discretionary parts of the job are clearly dependent upon mental effort.

As experience is acquired in a particular job, the worker uses the memory more, and "raw" judgment or reasoning less. Instead of having to predict what might happen if he followed a certain course of action, the worker simply thinks about similar cases with which he has dealt in the past, and follows a tested procedure. Thus if a person remained in a job long enough, no new thinking would be required; action would be initiated by memory alone. Perhaps some discretion or judgment would be required in identifying situations and relating them to past experiences, but no new procedure or action would be followed.

Thus the change in mental effort required in a job can be considered to be a change from the extensive use of reasoning to the extensive use of memory.

MENTAL SKILL

The question of which of these is more difficult would be considered in a job evaluation study under the heading of skill—specifically mental skill. In the evaluation of skill factors, an attempt is made to determine the education, experience on the job and in related work, and trades training which would be required of a person to acquire proficiency at the job. Experience and specialized trade training tends to build up the memory file of successes and mistakes; education, it is hoped, helps to develop an ability to analyze a situation and think out a solution. It could be argued, then, that education other than that acquired in a trade school, is necessary to a worker only in circumstances where there is little chance of a precedent. Where the worker can rely neither on trade training, experience, nor standard instructions to deal with every situation, then presumably he must do some analysis and initiate action on his own. This assumes, incidentally, that his supervisor is not available to make that choice or initiate action for him. In order to take advantage of standardization and specialization, the supervisor should deal with the exceptions—the cases for which there is no experience or precedent. Thus we unearth a qualification or requirement for supervision which probably does not receive the attention it deserves in the literature of personnel placement, namely, the ability to think!

Mental skill requirements are considered to be greater where original analysis and judgment are required than where the job is predominantly prescribed by standard or precedent. As experience is acquired, however, the worker relies less on thinking and more on memory; hence the job as it is being performed changes from month to month. This change is often so subtle that it is difficult for the worker to recognize. An experienced worker will have difficulty identifying activities requiring discretion since he has been exercising this discretion for so long that it seems second nature to him. He has forgotten what parts of the job require judgment and what parts are strictly routine. Furthermore, even the supervisor cannot always clearly identify the discretionary parts of the job. He may have forgotten the questions asked by the novice or the mistakes which resulted from not asking questions. The net result of this acquisition of experience is that memory, rather than judgment, is the basis for what may once have been discretionary parts of the job. The basic requirement in this or any factor in a job evaluation plan is usually described as that degree required to perform the job with proficiency. At this point the worker has learned all he need know, has acquired sufficient experience to cover all predictable circumstances, and the bulk of the work is covered by percedent or standard instructions. Thus, less mental skill (analytical ability) is required at this proficient stage of learning than earlier when the learner had to reason, not having a backlog of experience upon which to draw.

In the earlier phases of learning a job, however, the worker calls upon his supervisor and the super-

[1]Jaques, Elliott *Measurement of Responsibility* (London, Tavistock Publications, Ltd., 1956) p. 33.

visor's experience to deal with the more difficult situations. This is related to the specification in job evaluation of responsibility.

RESPONSIBILITY

Essentially, responsibility is the assessment of the degree to which the worker is responsible or liable for errors or costs arising from his errors. This factor is usually subdivided into such headings as responsibility for machines and equipment, for materials, for production, for safety of others, for work of others, for quality of product, for company cash, for confidential information and records, for contact with the public, for determining company policy, for negotiating on the company's behalf, etc. In any of these factors, however, an attempt is made to determine the extent or seriousness of an error made. This is often measured in terms of dollars, being the loss to the company or cost to correct the error. An exception of course, is responsibility for safety of others where no price can be placed on loss of limb or life. Similarly it may be difficult to "price" or "cost" the loss of an important order, loss of prestige, or reputation. In any case an attempt is made to assess the implications and expense of not doing the job well. This assessment gives rise to a number of problems of interpretation, since those who are evaluating the job have been taught to think of the job's being done with proficiency. They must therefore assess the profitability that a proficient worker, exercising normal care and caution, will make a legitimate error. They must then assess the seriousness of such an error. In some cases a factor called something like "responsibility for errors" is included, but this would appear to be superfluous as each of the responsibility factors is designed to evaluate the responsibility for errors within a certain sphere or of a certain type.

The supervisor is by definition, also responsible for the subordinate's error and therefore must check to prevent errors on the part of his subordinates. If the supervisor checks every piece of work done by his subordinate, then there is no responsibility for quality of the final product in the basic job. There would presumably be a measure of responsibility for materials which would be based on the maximum amount of material which could be spoiled by a worker before his supervisor got around to check. As the worker acquires experience on the job, however, the supervisor might check the work less frequently. He might just make spot checks or eventually might rely on reports from outside the department or company to advise on the quality of workmanship of his subordinate. This changing emphasis on checking clearly represents a change in the responsibility of the job. Probably the chance of error or fault is less through increasing experience, but so is the chance less that that fault will be discovered!

Elliott Jaques, in the studies referred to above, uses the concept of time span of discretion. He argues that the best measure of the significance or size of a job is the length of time required to discover errors. Thus the bench worker whose work will be checked the same day by the inspector will have a short time span and relatively low pay, compared with highly-paid executives whose errors in policy-making may not become evident before several years have elapsed. Jaques argues that the time span is a central and significant attribute of a job which alone can be used as a guide in determining the rate of pay. He suggests that the rate of pay should be equivalent to the interest earned by an amount of capital equal to the maximum cost of an error which could be made by that individual. The rate of interest would be the going rate for borrowing by firms in the industry. He also points out the relationship between the time span of the job and the period for which a rate of pay is stated. That is, for a short time-span job, the rate is expressed by the hour whereas for a longer time span of discretion, the rate is expressed as a given amount per annum.

Jaques found considerable substantiation of his time-span theory in one study of a single company; further research will be necessary to develop a general theory.

The time-span concept is quite useful however, in thinking about problems of job content, and particularly about problems of supervision. As the supervisor gains confidence in the worker and reduces the frequency of checks on his work, he is at the same time increasing the time span of that worker's job. This essentially increases the responsibility of the job, a process which occurs simultaneously with the increasing use of memory (experience) and decreasing use of judgment or discretion.

This does not suggest that routine or prescribed parts of the job are not important. On the contrary, failure to comply with elementary safety rules, for example, could cause disaster. Similarly, carelessness in the placement of the decimal point could cost the firm thousands of dollars. Again, these are errors which the worker of average proficiency should not make—but does, occasionally. The question facing the job evaluator is a difficult one to resolve—what is the extent of damage or expense which could be caused by a legitimate oversight? Is any oversight legitimate? We admit that "to err is human" and presumably to forget occasionally is excusable, provided that it doesn't happen "too often". It becomes a matter for the supervisor's discretion as to how

often is too often, or what frequency of oversights warrants dismissal.

Supervisors may find some consolation in the knowledge that a machine such as a computer, or in fact any programmed control device, doesn't forget. Indeed it is intriguing to compare the prescribed part of a job with the activity of which a computer is capable. A computer may receive information, compare it with certain standard values, and then follow various instructions in accordance with the results of these comparisons. For example, the computer as a manufacturing control centre may receive an order, and determine whether the part is in stock or not. If it finds the part in stock, it can be programmed to issue shipping instructions. If the part is not in stock, the computer may issue a manufacturing order for a predetermined quantity. At the same time it maintains a perpetual inventory record. Computers have been programmed to compare the balance-of-stores records with predetermined re-order levels, compute an economic order quantity and issue the order. Many of these activities are more challenging than many jobs done today by clerical workers, and they can be done much better by machines than people, for it is necessary to instruct or program a computer just once. Then, provided the machine is in good mechanical and electrical condition, it cannot forget, and performs the tasks as instructed with extreme accuracy and speed. Humans require some time to be "programmed" or to learn indelibly the proper course of action under given circumstances.

It would seem that the unique contribution which the human can make in industrial or business activity to-day is initiative and resourcefulness, or ability to deal with a new situation—an ability to analyze a set of circumstances, and prescribe and implement a course of action. Of course it will not be practical or feasible to immediately mechanize or "computerize" the prescribed portion of all jobs and retain for people just the thinking part. Many people are neither willing nor qualified to exercise discretion. Many individuals who have for years been following instructions without exercising judgment would not be able to suddenly move in to do a discretionary job. Had these people been given discretionary jobs from the outset of their careers, however, their minds and temperaments would be conditioned and developed for that type of activity. On the other hand, many people might not develop even if given the opportunity from youth.

It is unfortunate that the superior discretionary mechanism of the human mind is not always utilized to capacity. It is to be hoped that as automation and mechanization progress, people will be saved for those jobs which only people can do, and will be spared those jobs which can better be done mechanically.

As long as people are doing work, however, the problem of identifying and allowing for changes in job content will remain.

In at least one Canadian company, an attempt has been made to recognize the changing nature of jobs. In this case, the job (of a professional nature) and the man performing it are evaluated together and a new rate established, if justified. This combination job evaluation-merit rating plan acknowledges that a job will grow with the man. Periodically employee performance of the jobs and the changes which have taken place are reviewed and the jobs re-evaluated.

Elsewhere it is usually the custom to call for review of the whole job evaluation plan annually or as often as necessary to set up rates for new or noticeably changed jobs. Unfortunately the changes which occur unnoticeably are disregarded. Further, the best intentions of annual review are often overlooked in favour of more pressing business. Thus the creeping changes in job content are not normally recognized by a job evaluation procedure—a situation which could result in an inflexible rate structure and the accompanying problems of loss of good employees through failure to acknowledge this superiority or extra contribution over and above that called for in the job description.

In summary, the creeping changes are exemplified by increased responsibility assumed by the employee as he gains experience; requiring less supervision, and resulting in increased time span. On the other hand, less of the work of the experienced employee depends on the ability to think and more on the ability to memorize.

RESEARCH: HANDLE WITH CARE

Information is available fact. Knowledge is acquired information. Wisdom is applied knowledge. Somewhere in this processing of information into wisdom we become interested in truth as an enduring target for the intellect in action. Under skilled and moral direction, research—the science of fact-finding according to specification—can illuminate truth. Used selectively by the inept or the partisan, it is a tool of half-truth and confusion.

Research is no better than the wisdom of the man applying the findings to an unanswered question. Applying fact-finding to human behaviour is the most vexing of all research projects, because the framing of the question is just as significant in responsibility as the meaning of the answer. No research project can present statistical findings immune to the influence of personal judgment, or beyond the need of ethical interpretation.

Common Stocks as Estate Investments

— *the current outlook*

The late Erle Steiss presented a case for the inclusion of common stocks as investments for estates in an article published in the Business Quarterly, Summer, 1951. *Subsequent events have confirmed the wisdom of this policy, but changing economic and political conditions suggest that it is time to take a new look at the investment environment and its influence on this policy.*

E. D. L. Miller

This is a very broad subject and it will not be possible to cover all aspects of it. Nevertheless certain changes which have occurred are of such basic importance that they must be developed in some detail. These seem to fall most readily under the following headings:

1. Inflationary Pressures.
2. The Yield Spread between Stocks and Bonds.
3. The Rejuvenation of U.K., Europe and Japan.
4. International Political Tensions.
5. Some Domestic, Political and Economic Developments.
6. Psychological Changes.

INFLATIONARY PRESSURES

Inflation is most commonly measured by the cost-of-living index since revised and now known as the Consumer Price Index. This index rose from 72.9 in 1942 to 113.7 in 1951, or by 55.9%, while in the last nine years from 1951 to 1960 it has only risen from 113.7 to its current level of 127.4, or by 12%. This would seem to indicate that the factors which create inflation are beginning to lose their potency or are being held in better check.

Now let us examine some of these in relation to the two most common definitions of inflation. The more orthodox form of inflation is caused by too much money chasing too few goods, and undoubtedly this was the case in the years immediately following World War II and during the first years of the Korean War. However, largely as a result of massive expansion of productive capacity in almost every industry on the North American continent, we have had since roughly 1955, over-productive capacity and a supply of consumer and capital goods in excess of demand. Even an abnormal increase in the money supply in 1958 caused little, if any, strain on the productive capacity available. Despite a continuing increase in population, there is hardly any expectation that demand for goods, generally speaking, will tax productive capacity in the next few years unless a global conflict again develops. On the basis of this definition, a deflationary period might even be anticipated.

More recently, the theory has been advanced that current inflationary trends are of the cost-push variety, i.e., costs are being forced up, with an inevitable effect on prices. Such costs are labour, raw materials, taxes, interest on borrowed capital, packaging, transportation, advertising, etc. The most important are labour and raw materials, and statistics would indicate some lessening of the cost pressure in these areas in Canada. The Dominion Bureau of Statistics Average Hourly Earnings index showed an increase from 56.1 cents per hour in 1942 to $1.168 in 1951, or 108.2%. The increase since 1951 to the present level of $1.77 per hour is only 51.2%, and in the last three years the percentage increase approximates just 10%.

If we can use the General Index of Wholesale Prices as being indicative of the trend in prices of raw materials, there would appear to have been little or no pressure since 1951. While this index almost doubled from 123 in 1942 to 240.2 in 1951, it declined to 214.3 in October of 1954 and is currently about 231.3 or still about 3.7% below the level reached in 1951.

Other cost items have probably risen, but statistical evidence is lacking, and their effect on final costs is relatively less except in the case of tobacco, liquor, gasoline and a few other products which are prime targets for taxation.

What are the reasons for the apparent slackening in the rate of inflation and what can be said about the near-term outlook? As we have already indicated, productive capacity has overtaken demand and there is no longer a public with more-than-ample cash bidding up the prices of a limited supply of goods. The resultant intense competition seems to be effectively keeping a lid on prices. In fact, in farming and some industries such as housing construction, were it not for government support in the form of subsidies, floor prices and large direct loans, prices would undoubtedly be lower than they are today. Government and monetary authorities in most of the major countries in the free world have grown to realize the great dangers in inflation—not only the effect of rising prices, but also the lack of confidence which can develop in the monetary unit, with ultimate disastrous consequences. As a result, fiscal and monetary measures designed to control or curb inflation are being taken more readily and appear to be meeting with wider public acceptance.

It would also appear that some of the major labour unions, whether through a growing sense of public responsibility, better economic education, or because their bargaining position has been weakened more recently, are prepared to settle contract disputes on a less inflationary basis. It is becoming more evident that the contract settlement at the turn of the year in the United States steel industry dispute was one of the least inflationary in recent history, as well as being one of the most important. The smaller rate of increase in the Dominion Bureau of Statistics Average Hourly Earnings index would appear to support this thesis, at least in part.

Industry, as a result of the intense competition which has been squeezing profit margins (witness the many companies whose sales are increasing without commensurate increase in net profits), is striving, through technological improvement and automation of clerical and manufacturing procedures, to cut costs of production, with some evidence of success. This is true no less in the service area than in manufacturing. Industry is also fighting to reduce featherbedding practices on the part of labour, again with at least partial success. The elimination of firemen on yard diesels by the Canadian Pacific Railway has been a significant step in this direction.

In summary, then, with ample productive capacity, with governments aware of the dangers of inflation and prepared to use their fiscal and monetary tools to fight it, and with an improvement in industrial efficiency, the outlook for the foreseeable future seems to be one of much more moderate inflation. Looking further into the future, the growing acceptance of a government philosophy of full employment and the welfare state (on which it is doubtful that we can ever turn back), there is every likelihood that we will have inflation in varying degree, with slight prospect of any prolonged deflationary periods.

THE YIELD SPREAD BETWEEN STOCKS AND BONDS

In 1951, yields on most common stocks were in excess of yields obtainable on corporate and government bonds and provided an income incentive for the investor to buy stocks as opposed to bonds. Since then, this relationship has altered and can best be illustrated by the following table showing a sample list of good quality bonds and stocks with their prices and yields at May 1, 1951 and May 2, 1960.

It can readily be seen that all of the yields on the representative list of bonds increased substantially while the yields on most of the stocks have declined, albeit not to the same extent. Taking an arithmetical average of the yields, we find that in 1951 the common stocks in this list yielded more than the bonds by .95%, whereas in 1960 the bonds yielded more by 1.60%. Admittedly the Government has increased the tax credit on dividends from Canadian common stocks to 20% from the 10% level existing in 1951; nevertheless, the attractiveness of this credit has diminished somewhat, particularly in comparison with the low coupon bonds selling at a discount which, if held to maturity, provide tax-free capital appreciation as part of the yield.

Even a glance at the list illustrates vividly the capital depreciation which has occurred in accounts invested entirely in bonds. To maintain capital values during this period, common stocks have been a "must" for security portfolios. Obviously, to provide for capital appreciation or growth in a portfolio, a larger proportion of an account should have been invested in commons.

Undoubtedly one of the factors contributing to the recent decline in the prices of Canadian common stocks has been the increasingly attractive yield on bonds as some investors have decided to capitalize

Security	May 1, 1951 Price	Yield	May, 2, 1960 Price	Yield
Canada 1¾/Nov. 1/52	$99.30	2.23%		
Canada 3/Dec. 1/61			$98.45	4.02%
Canada 2¾/June 15/68	94.125	3.20%	85.50	4.94%
Canada 3/Perpetuals	96.75	3.10%	68.50	4.38%
Ontario 3/Dec. 15/70	93.00	3.50%	82.50	5.15%
Ontario 6/Nov. 15/79			104.00	5.66%
Abitibi Power & Paper 3½/Apr. 1/67	98.00	3.67%		
Abitibi Power & Paper 6¼/Nov. 15/77			101.00	6.15%
Aluminum Co. 3½/Jan. 2/71	99.00	3.57%	84.00	5.48%
Gatineau Power 3¼/Jun. 15/70	96.50	3.50%	82.00	5.65%
Imperial Tobacco 3/Mar. 1/70	93.00	3.50%	82.00	5.38%
Steel Co. of Canada 2¾/May 1/67	92.00	3.40%	86.00	5.13%
Dominion Foundries & Steel 4½% Pfd.	99.50	4.52%	97.50	4.62%
General Steel Wares 5% Pfd.	105.00	4.76%	88.00	5.68%
Supertest Petroleum 5% Pfd.	100.00	5.00%	91.75	5.45%
John Wood Industries 4½% Pfd.	103.00	4.36%	85.00	5.29%
Bank of Montreal c/s	29.00	4.14%	50.00	3.60%
Canadian Bank of Commerce c/s	25.00	4.00%	50.00	3.60%
Royal Bank of Canada c/s	27.00	3.70%	67.00	3.36%
Aluminum Ltd. c/s	16.50	3.48%	28.50	2.11%
Burns & Co. c/s	9.25	5.40%	12.50	6.40%
Canadian Celanese Ltd. c/s	58.00	4.14%	18.63	5.37%
Consolidated Paper c/s	20.00	5.62%	39.38	5.08%
Consumers' Gas Co. c/s	16.00	5.00%	37.25	2.68%
Dominion Foundries c/s	12.50	4.00%	43.75	3.20%
Hudson Bay Mining & Smelting c/s	60.00	8.33%	43.00	6.98%
Imperial Oil Ltd. c/s	38.00	1.58%	31.25	3.84%
International Nickel Co. c/s	19.00	5.26%	50.88	2.95%
International Paper c/s	58.00	5.17%	99.50	3.02%
Shawinigan Water & Power c/s	13.00	3.08%	26.88	2.98%
Steel Co. of Canada c/s	33.00	2.42%	73.50	3.27%
Hiram Walker-Gooderham & Worts c/s	18.66	6.34%	35.88	4.88%

Note: Stock prices at May 1, 1951 have been adjusted to allow for subsequent stock splits where applicable.

some of their profits on stocks, content to sit for the time being with a larger bond position. We only have to look back to August and September of 1959, when it was possible to buy short-term low coupon Government of Canada bonds with yields in excess of 6%. Although bond yields generally have declined since then, they are still at levels which previously have not been seen for almost 30 years.

On an historical basis, the existing relationship between bond and stock yields is abnormal; invariably it has been reversed. This can result from one or more of the following causes:

(1) A decline in interest rates.

(2) A decline in stock prices.

(3) An increase in dividends.

In the past few months, all of these have happened, though not yet to an extent sufficient to bring stock yields on average in excess of bond yields. Possibly all three trends will continue to develop. However, there seems little likelihood of substantial dividend increases, and our monetary authorities have predicted a continuation of relatively high interest rates into the foreseeable future.

THE REJUVENATION OF U.K., EUROPE AND JAPAN

Unlike Canada and the United States, the economies of most industrialized countries including Russia and Japan, were disrupted or badly damaged during World War II. As a consequence, the rebuilding of those countries acted as a stimulant to the economy of this continent. Obviously the United States was the chief benefactor but Canada profited as as well in a more indirect manner. Now, with lower costs and in many cases more modern productive equipment, these countries are capturing much of our export market, particularly for manufactured goods but also for raw resources; witness Russia's sales of aluminum, lumber and more recently oil. This is, however, only part of the picture, as these countries have invaded our domestic markets with ever-increasing vigour and to the obvious concern of some of our manufacturing industries, notably automobiles, electrical equipment and textiles.

There has been much public discussion of the vulnerability of our economy to Russian penetration of world markets, as so many of their raw resources are similar to ours and in roughly the same abundance. One might expect that Russia would direct her efforts to consumer goods production to satisfy the desires of her large population; but at the same time it is apparent that she is prepared to sell her raw resources at prices below prevailing world prices. Whether this is dictated by purely political motives or not is a matter of conjecture. Her policies in this regard for the future can not be gauged.

As our foreign trade is large in relation to our Gross National Product, with exports probably running about 19% of estimated Gross National Product for 1960; as improvement in communications and transportation are bringing the countries of the world closer together; and as international political tensions rise, we are faced in the years ahead with the very difficult problem of where, how and to what extent, if any, we can protect those of our industries which are being seriously affected by competition from these lower-cost economies. Increased efficiency and technological improvements, combined with aggressive salesmanship and merchandising, will help. But possibly more important is the necessity of controlling our desire for a better standard of living and a welfare state within reasonable limits while the standard of living of these other countries catches up to us. Their costs will eventually rise at a greater rate, thus reducing their present cost advantage. If hourly wage rates can be taken as an indicator of this trend, in the period 1953-1957 wages in West Germany, France and the Netherlands all increased by more than 30% as compared to an 18% increase in Canada; Italy had an increase of 23% in the same period.

The development of Trading Blocs, notably the European Common Market and the Outer Seven, further obscure our economic prospects in the near term.

INTERNATIONAL POLITICAL TENSIONS

Vast changes far too numerous to detail have taken place in the international political scene since 1951, and it is extremely difficult to summarize and assess their effect. Probably they can be best appraised if looked at in three broad aspects, all of which are interrelated.

(a) The Russian-Chinese bloc has become aggressive in an economic as well as in a political and military sense. They are using economic aid in the form of loans, barter agreements and technical assistance to the underdeveloped countries and to countries which, at the time, have at least tactical political importance. Examples are plentiful and include India, the United Arab Republic and, most recently, Cuba, while overtures are being made to the new Congo republic.

(b) The nationalistic aspirations of many former colonies of the European countries are achieving fulfillment, and with it are creating new problems. In most instances, large proportions of their populations remain illiterate, with the result that the countries are being governed by a relatively few educated but generally fanatic individuals whose main aim seems to be to stay in power. To accomplish this they are playing the Communist bloc against the Western powers, and are conducting their economic and political affairs more from expediency than long-term planning for their ultimate benefit. As these countries provide the source of many raw materials, there is a constant uncertainty in the market for these products. Nationalization of the companies producing the products or expropriation of their properties is a continuing threat. Much more should be done by the Western Powers to hasten the education, develop the economies and raise the standard of living of these peoples. Such programs, however, have to be paid for in the final analysis by taxpayers, and whether this will be politically feasible is debatable.

(c) The possibility, whether by accident or by design, of a major military conflict is probably greater today than it was nine years ago. Russia and the United States have the hydrogen bomb and missiles with which to deliver it. Russia is talking and acting with increasing belligerence. It is safe to say that there will be little let-up in the rate of defence expenditure in the Western countries, but at the same time it is also probably true that these expenditures will not rise substantially from present high levels. Canada

will likely have greater success in holding the line than the other major powers.

If it is possible to sum up this situation at all the following conclusions might be drawn:

(1) International crises will continue to occur and will cloud the stock market outlook. It is doubtful if the Canadian market will be stimulated by these events, and it may be depressed.

(2) There is no point in attempting to assess the effects of a major military conflict.

(3) In so far as programs for aid to underdeveloped countries are expanded, they will tend to be inflationary and to foster economic growth.

(4) Segments of our economy will be adversely affected by competition from lower cost economies in foreign and probably domestic markets for several years at least.

SOME DOMESTIC, POLITICAL AND ECONOMIC DEVELOPMENTS

Although the Government has taken fiscal and monetary measures designed to curb inflation from time to time during the past nine years, it has not been able to resist the relentless pressures to spend more and more money. According to the Dominion Bureau of Statistics, Government Expenditure on Goods and Services has more than quadrupled in the period 1947 to 1959, while the Gross National Product has increased about two and a half times.

Old Age Pensions have been increased from $40 to $55 per month, a National Hospitalization scheme has been developed in co-operation with the Provinces, over one and a half billion dollars have been made available for direct loans to housing since 1957, Unemployment Insurance benefits have been broadened, and currently the Provinces are seeking a larger share of tax revenues. Regardless of the social merit for these and many other such schemes, the fact remains that they contribute to inflationary pressures.

A word should be said about the country's credit structure. While the Federal Government and a few of the Provinces have contained within reasonable limits, or even reduced, their debt, the same can not be said for the rest of the Provinces, many municipalities and individuals. The last may be the most important, as in the final analysis it is the consumer's ability to spend which supports our economic growth. Unfortunately, figures are lacking on the most important segment of consumer credit, namely mortgage debt. Mr. Jules E. Fortin of the Dominion Mortgage and Investment Association has given us an educated guess that the figure is somewhere between $10 billion and $11 billion, exclusive of bond mortgage debt. We do know that consumer credit outstanding has risen from $1,743 million in 1954 to $2,970 million at the end of 1959, exclusive of personal loans with Life Insurance Companies and secured personal loans with the Chartered Banks. In substance, the consumer debt has increased in large degree since 1951, and although it may still be far from critical levels, further increases will not likely provide the same stimulus to business as in the past nine years.

Our economy seems poised on a high level. Two recessions have occurred since 1951, the first in 1953/54 and the second in 1957/58. Both of these were mild, due in no small part to active government intervention. Will the government be as successful the next time? This is a question that nobody can answer with positive assurance. Some feel that further large scale pump-priming will in time lead to a loss of confidence in our currency and will end with disastrous consequences. Others feel that government measures to slow down booms, increasing population, technological improvements, new products, social security schemes, etc., will tend to level out the wider fluctuations in business cycles.

PSYCHOLOGICAL CHANGES

Stock market cycles tend to be influenced by mass psychology, and this factor never seems to be apparent in advance. Looking back, it would seem that investors began to be optimistic in the early 'fifties', became overly optimistic in 1955, 1956 and 1957, began to lose some of this optimism after the sharp break in stock prices in the fall of 1957, and are now uncertain or even pessimistic. If this psychological cycle is to run its full course, we likely have a period of even deeper pessimism to go through.

One measure of this psychological factor might be the value of shares of stock traded; this is more realistic than volume, because the latter is distorted by the penny speculative stocks. Referring to the Dominion Bureau of Statistics figures for the Toronto Stock Exchange, we find a sharp increase from a monthly average in 1951 of about $98 million to a peak in 1955 of $224.9 million, while this year so far is producing a monthly average of about $100 million. Considering that the quoted market value of shares listed on the Toronto Stock Exchange has approximately quadrupled in the same period of time, there appears to be added significance to the current low level of trading. Admittedly it could also mean, to some extent at least, that common stocks are moving into stronger hands and are being retained in portfolios on a more permanent basis.

CONCLUSION

The principles of stock selection are the same today as in the past. Possibly a greater degree of skill is required because of increasing competition in business and over-productive capacity. To be a sound investment, a company must be in sound financial condition, engaged in a basic and growing industry, one of the leaders in its field and finally, must be well managed.

Stocks still properly occupy a place in the investment portfolios of Estates and Trusts. It is interesting to note that the same fixed fund of 25 common stocks, to which Erle Steiss referred in his article in 1951, having an original market value of $25,000 in 1927 and a value of $49,208 in April of 1951, climbed to a peak of about $81,500 in February of 1959 and at May 31, 1960 was worth $72,127. Total dividends taken out in the 34-year period amount to $57,775, producing an average annual income of 7%. Of the 25 stocks, five have depreciated in value and 20 have appreciated, with two of them showing increases of 1153% and 1234% respectively. As no investment management was given to this hypothetical fund, its performance over such a long period of time including the Great Depression, World War II, the Korean War and post-war recessions would seem to be striking proof of the wisdom of including common stocks in estate portfolios.

The question today is not whether common stocks are proper investments for Estates, but rather the extent to which they should be included in the portfolio. Each Estate has its own characteristics and requirements, and of course it is impossible to lay down a fixed percentage of common stocks to be applied to all accounts.

Our company is currently following a policy of recommending that common stocks be kept close to the minimum requirements for each account. As far back as 1955 and 1956 we found, largely as a result of price appreciation, that many of our Estates and Trusts were investing as much as 70% to 90% in common stocks. Even then we felt that the boom in Canadian common stocks might be topping out, and that these high percentages made such accounts too vulnerable to the uncertainties which were developing. The nature of investment analysis is such that nobody can ever be sure of future developments, and because it is impractical if not impossible for a large Trust Company suddenly to unload major proportions of its common stock holdings, and because a long-term investment policy is prudent for Estates and Trusts, we developed a policy over the last 4½ years of gradually reducing these holdings. This policy has been consistently made known to our clients through written recommendation and verbal discussion during this period. It is notable that the Dominion Bureau of Statistics Composite Stock Index is currently about 18% below the high attained in August of 1956.

In adopting this policy, the following factors seemed to us to be most pertinent.

(1) Stocks had reached price levels where their price/earnings ratios were at or close to historical highs.

(2) Switching from stocks to bonds capitalized profits in most instances, improved security, and could even better the yield being obtained; where income was of prime importance and the 20% tax credit of value, preferred stocks also had merit.

(3) The government and monetary authorities seemed more determined to combat inflation.

(4) We felt over-productive capacity in most industries would retard price increases and squeeze profit margins.

(5) Foreign competition from low-cost economies was bound to have an adverse effect on certain segments of our economy.

(6) Increasing international tensions created uncertainty.

Having said all this, let me reaffirm our basic belief that common stocks are a proper investment medium for Estate investment and that our current policy is one of de-emphasis only from overly-large proportions of many of our Estate portfolios. It should also be born in mind that Trustees in Canada may only invest in common stocks where the Will or other Trust Document specifically gives them the power so to do.

AFL-CIO DESIRE TO DIVERT WELFARE FUNDS TO HOUSING

George Meany, president of the giant AFL-CIO, has announced a plan to promote the investment of more of the members' welfare funds into home mortgages. The present total in the U.S. of members' welfare funds is estimated at $40 billion.

The announced purposes of the plan are to help solve the nation's housing shortage, to provide employment and to provide downward pressure on residential mortgage interest rates.

Of course, the AFL-CIO cannot order the adoption of such an investment policy. It can, however, encourage its member unions to insist on the adoption of certain investment policies in their bargaining with employers on pension and welfare matters.

Since pension and welfare funds are becoming such large and important depositories of U.S. (and Canadian) savings, we can probably look forward to organized labour taking an increasing interest in the manner in which these savings are put to work.

—Canadian Actuarial Bulletin
September, 1960.

FOREIGN LICENSING

— *an export alternative*

In the article which follows, the author discusses some of the pros and cons of using foreign licensing agreements in lieu of, or along with, an active export program. Some of his findings are based on a field survey, the results of which are reported in the article.

J. G. MYERS

There has been much talk recently about Canadian manufacturers being priced out of world markets. The proof of this would require a penetrating analysis of trade statistics and a detailed company-by-company examination of pricing and distribution policy. It is undoubtedly true, however, that some domestic manufacturers, large and small, have watched their export sales decline appreciably in recent years.

The pressure of foreign competition on Canadian manufacturers has taken two forms: foreign manufactured products have been able to undersell Canadian goods in foreign markets, and they have been able to undersell Canadian goods in Canada. One Canadian manufacturer recently described foreign imports into Canada as an "enormous flood" which in the '60s will expose companies to "the most tremendous international struggle for markets the free world has ever witnessed".[1]

A picture of the pattern of over-all Canadian trade is contained in a recent report by Dr. G. L. Reuber. It shows that Canada has traded proportionately more each year with the United States and that this pattern will continue. Dr. Reuber states that "by 1980, almost 70 percent of Canadian exports may be sold in the United States compared with some 60 percent at present." Whether or not this is desirable is a question of national policy which will not be examined in this article. Of significance, however, is the implication that Canadian exporters will be less able to compete in foreign markets other than the U.S. market.

This article will briefly examine some of the alternative courses of action open to Canadian manufacturers faced with declining export sales or strong domestic competition from foreign imports. The foreign licensing alternative will be examined in particular detail, and the paper will report on the results of a survey designed to see what kind of experience Canadian manufacturers have had in foreign licensing. Brief consideration will also be given to foreign licensing as an instrument of international association. The summary and conclusions will cover some of the problems inherent in foreign licensing, and will provide some answers to the question of whether or not this is a worthwhile alternative in the drive to recapture lost exports.

About one-third of Canadian exports are fully manufactured goods. Although the largest percentage of our exports goes to the United States and is in a raw or partially-finished state, a significant amount does go from Canadian factories to other countries in a fully-manufactured state. At least $500,000,000 is exported from Canada in this way. It is probably this group which has suffered most from declining exports. Although this article is primarily directed to them, a no less interested audience should be other Canadian manufacturers regardless of whether they do any export or foreign business. Foreign licensing may provide them with an opportunity of increasing profits through foreign manufacture.

It is not the intention of this article to discuss the pros and cons of doing more international business with countries other than the United States. It is assumed that this is desirable. The examination will concentrate instead on the ways and means of increasing foreign business, and will consider in detail foreign licensing as one of these means.

POSSIBLE SOLUTIONS

At least seven suggestions have been made in recent months by Canadian business and government leaders to accomplish the objective of increased exports. They are:

(1) Lower manufacturing costs through specialization and increased volume;

(2) Eliminate the premium on the Canadian dollar;

(3) Create a long-term export financing corporation;

(4) Regroup industries in commodities in which we have maximum advantage;

(5) Establish a free trade area with the United States and South America;

(6) Improve foreign marketing techniques;

(7) Establish association with, or investment in, foreign companies.

This article will be principally concerned with the seventh suggestion.

There are three broad alternative forms of foreign manufacturing arrangements: establishment of a wholly-owned subsidiary; merger with an established foreign company in which the Canadian holds an interest; and, licensing of patents, trademarks or technical know-how to a foreign manufacturer.

One manufacturer in a recent survey on foreign licensing agreements listed the following reasons for manufacturing certain products overseas:

a) To maintain a market which has been built up for our name and product, but in which we can no longer compete pricewise because of local competition.

b) To maintain our position in a market for either a single product or our complete line which could no longer be imported due to government import regulations instituted either because of the lack of foreign exchange or to protect local industry.

c) To take advantage of low cost production facilities in order to exploit those markets which are interested primarily in price rather than quality.

FOREIGN SUBSIDIARY

Establishing a foreign subsidiary generally involves the largest capital expenditure. Because of this, it is more risky—domestic funds are transplanted to the foreign country; the parent must assume the risks of operating effectively in a foreign environment; government expropriation might occur; wars, economic fluctuations and a host of other difficulties resulting from long range communications, government controls, etc., are possible. A real danger in starting from scratch is that the home company may unknowingly transplant its management ideas into the foreign environment and find, after investing heavily, that what works in Toronto does not necessarily work in Tokyo or Mexico City.

The principal advantage of this type of foreign arrangement is that it assures the maximum amount of control in subsidiary management. There is a greater likelihood of building and maintaining an international company image. Efficiencies arising from centralized control are more easily implemented. Obviously, this form of corporate organization will be used most by large companies who can afford the initial capital outlay and the substantial risks involved.

PARTIAL OWNERSHIP

A second alternative to the establishment of a foreign operation is partial ownership. The percentage of ownership, and the conditions of the association, can vary widely. The three principal arrangements are: majority interest held by home company; majority interest held by foreign company; or an equal split between the two. The type of arrangement affects the degree of absolute control which the home company has over the foreign, but is not necessarily a criterion for a successful relationship. There are many examples of good and bad experiences under all types of agreement. Obviously, there is less investment involved in this alternative than in the former, not only in initial capital outlay but also in setting-up expenses, training managers, and getting a new business underway. However, there is an investment involved and the company must still assume risks and also be exposed to the possibility that, without a majority of the stock, effective control lies within the other partner. This was the case of a well-known Canadian manufacturer who bought a 30%interest in a foreign company which was family-controlled. All conditions of the arrangement seemed favorable, and foreign management had agreed to implement many of the operating policies of the Canadian company to bring its plant up to maximum efficiency. However, when the time came to implement these policies, Canadian management was unable to get them put into effect. After two years,

the Canadians were forced to present an alternative to the foreigner: sell the Canadian a controlling interest, or have its stock dumped on the foreign market. The outcome of this case has still not definitely been determined.

Why doesn't a company always insist upon a controlling interest? Obviously, the foreign company is often reluctant to give this up, and, in some countries, it is illegal for a foreign company to hold a controlling interest. The primary advantage of this type of arrangement is that the investing company has a partner rather than an employee. That is, the foreign company, with a stock interest, has more at stake and will naturally be more enthusiastic about seeing that operations are profitable. Also, the investing company purchases a going concern made up of local nationals who are best able to understand the intricacies of operating in their own foreign environment. Companies find that it is often easier to deal with foreign governments with this type of an arrangement than with one of 100% ownership.

FOREIGN LICENSING

The third alternative, and the one about which this article will be primarily concerned, is foreign licensing. Under this arrangement, the home company licences its patents, trademarks or "know-how" to a foreign manufacturer who, because of the nature of his products, his lack of patents, trademarks or "know-how", can advantageously use them. The following are some of the advantages to the Canadian manufacturer of this kind of arrangement.[1]

1. Overcomes local import and dollar restrictions.
2. Usually no direct capital investment is required.
3. May stimulate export of non-licensed products from home country because tariff rates on components are often lower than on finished articles.
4. Avoids complex labour and social regulations which might be present in the foreign country.
5. May open avenues to other markets where branch or subsidiary operations are not practical.
6. May provide a means of protecting trademark and patent rights which could not be done effectively otherwise.
7. Provides an opportunity to continue manufacture of products which are obsolete in the home market.
8. Gives home company an opportunity to produce its products at lower cost and reimport them for sale on the home market.
9. In some countries legal complications can be avoided because the licensee is able to remain outside the jurisdiction of the foreign government and its courts.
10. The home company can use its royalty and dividend earnings to reinvest in the licensee and eventually gain control.
11. An increase in sales and profits enables the home company to invest more in research and development.
12. The licensee may provide reciprocal know-how and operating experience which could be of benefit to the home company.
13. Foreign markets can be used to test new products.
14. Licensing of one product builds up goodwill for other products and the establishment of a favorable company image in the foreign market.

Some of the disadvantages are:

1. The licensor has no voice in control or management of the licensee company.
2. The licensee may grow so rapidly that the benefits of a continued relationship are no longer important. Once the contract has been entered into, the licensor contributes something of value. The agreement cannot always be protected legally and, once concluded, the licensee is free to use whatever he has gained from the licensor. In this respect, the licensor may, in effect, establish a formidable competitor.
3. Unless the exchange of know-how and industrial property rights is particularly good, or the opportunity for eventual ownership exists, the limited profit potential may not be worth the risks involved.
4. Some of the company's foreign agents may have to be dropped and they may retaliate negatively.
5. The negotiation and formalization of a license agreement is very complicated and costly and returns are often less than 5% on sales. Management may be unwilling to invest the time and effort involved for such low returns.

Licensing can best be described as a marriage of two companies which can work better together than apart. One company is usually the dominant giver,

[1]This list is taken from a report prepared by a graduate student at the University of Western Ontario under the author's supervision.

and in exchange for its contribution receives a royalty fee from the receiver. The usual license contract does not involve an investment of capital by the licensor in the licensee. The licensor's contribution is in the form of technical service or know-how, trademarks or patents. The most frequently licensed rights are trade marks. Technical service and know-how agreements may include blueprints, patterns, bills of material, supervisory and managerial services, technicians, trading facilities of the licensor, marketing information and facilities, research and new product information, maintenance services, manuals, quality control techniques, trade information, and purchasing facilities and services. An indication of the scope of licensing agreements is given in the following quotation:[2]

> Licensors may be international or export subsidiaries of a foreign company (e.g. Canadian subsidiaries may be licensed to sell in Commonwealth countries); a subsidiary organized to serve as a foreign holding company or profit sanctuary for earnings from overseas operations of the Canadian parent and/or subsidiaries; a patent licensing pool or some middleman agency authorized to negotiate and supervise license agreements; manufacturing agent; and two or more Canadian companies merging their license operations. Licensees may be majority or minority controlled manufacturing or non-manufacturing subsidiaries, manufacturing or non-manufacturing local companies in which the Canadian company has no interest, individuals, local governments and government-sponsored individuals. Licensees may be restricted to manufacture of certain components or finished parts or perform only the assembly and packaging functions. The usual arrangement is to have two or more foreign companies as parties to one or more agreements. One may be licensed to manufacture and another to distribute. A further complication is added when the licensor combines equity participation in the agreement.

For a great many companies, foreign licensing is impractical. Mr. Rudolph Kuhlman, in his article, "To License or Not to License," says "Even an accepted and widely used patent in this country may have no utility in any foreign country, or if so, may have to be thoroughly redesigned. Many products are not adaptable to foreign markets or competitive products exist in the foreign market which makes licensing impractical." Kuhlmann lists the following factors to be considered in deciding whether or not a manufacturer's products are licensable:

> (1) When he has already developed an export business to a country, thus proving that his product can be adapted to the needs of the people there; or if he comes late to his export markets and his American competitors making closely similar products have already established manufacturing operations there and thus proved the market.
>
> (2) When he is losing his export business for seemingly permanent reasons.
>
> (3) When he has enough volume in any one country to stand the expense of passing over the necessary engineering education. For a typical manufacturer with a fairly broad line of products requiring a reasonably complicated manufacturing procedure, he should see at least $2,000,000 annual volume. Due allowance must also be made for the possible increase in volume once the advantages of production inside the country have been achieved.
>
> (4) When the situation from the foreign manufacturer's viewpoint is as favorable as his own. Any serious license involves a substantial cost to the licensee. The foreign manufacturer must weigh carefully each of the same factors as the licensor and consider his own appraisal of whether the possible volume of business will show him a profit over these costs.

One manufacturer has listed the following conditions best suited to a licensing agreement:

1. The cost of the product includes considerable labour cost.
2. The product is heavy or bulky or both.
3. The licensee has facilities to produce a considerable portion of the finished product.
4. The Importing Country has a deficit balance with the exporter and foreign exchange is not available.

Patent or trademark protection may be had in any quantity or quality desired. Know-how agreements are the most difficult to protect. Careful selection of licensees, careful drafting of the license agreement to include secret data provisions, provisions for return of all material, licensee-employee contracts, and if possible the inclusion of a provision making the licensee liable for damages if officers and employees give out secret data and material are a few of the means available for protecting know-how agreements. The legal complications of any license agreement are

[2]From the student report mentioned earlier.

very involved, and the prospective licensor should hire qualified legal counsel both at home and abroad.

Royalties or service fees are the main source of income to the licensor. They usually include the following:

(1) Initial payment—a lump sum paid at the beginning of the agreement for the initial transfer of special machinery, parts, raw materials, blueprints etc. It usually includes the costs of negotiation and training licensee personnel,

(2) Annual minimum—the amount which the licensee *must* pay each year to the licensor. Royalty income does not necessarily have to equal list value, and some guarantee of a return is necessary.

(3) Annual percentage fee—the amount which the licensee agrees to pay the licensor each year. It is usually based on the invoice value of goods manufactured or certain percentage of sales or profits. The rate is contingent upon the expected volume of business, the value of the product, and the cost of selling it. Returns may vary from 2% to 30% but the average return is between 5% and 10%.

(4) Additional fees—some countries forbid initial payments; to cover expenses, a prepaid royalty of a certain amount is used. Additional fees may be negotiated to cover the costs of new drawings, new lines etc.

The foregoing paragraphs have described some of the alternative corporate relationships possible in foreign business and have examined in some detail the alternative of foreign licensing. A considerable amount of research has been done on this subject in the United States. Not only do American companies have more extensive foreign operations and there are more of them, but many of these subsidiary operations are Canadian. It is to be expected that decisions on licensing for an American subsidiary in Canada would be made in the United States, and this accounts for the greater amount of time and attention given to this subject there. The following quotation, taken from the replies to a survey conducted by the University of Western Ontario, is typical of the explanation of an American subsidiary in Canada concerning their experience in foreign licensing:

> The export business of our Canadian Company is very limited, consisting of occasional shipments to the West Indies. As you know, we are part of a large international company which has operating companies in many parts of the world. Marketing in those countries where we do not have manufacturing facilities is handled through a separate subsidiary in Geneva.
>
> Since most of the products which we manufacture in Canada are also made by our parent company in the U.S. and also in other countries, we do not have any exclusive product to offer to foreign markets. You can easily appreciate that with higher production runs in the U.S. and lower material costs, our U.S. company can produce its products for export at lower costs than we could in Canada.
>
> I think you will see from the above that we do not have a need for foreign licensing agreements for our company.

LICENSING SURVEY

It is interesting to speculate on the use of this type of arrangement in Canada. Canada's economy is heavily dependent on trade. Although principally with the United States, 40% is still with other countries. How many Canadian manufacturers use licensing in these countries? Is it a worthwhile alternative for those who are not now using it? These and other questions led to the initiation of our survey of Canadian manufacturers. A questionnaire was mailed to 160 Canadian manufacturers known to be in the export business. Known licensors were purposely selected so as to provide as much information about experiences with licensing agreements as possible. The sample did not provide a measure of the prevalence of licensing activity among Canadian companies. Companies receiving the questionnaire were asked to give their name, their chief export products, and their chief export markets. Questions concerning foreign licensing agreements were as follows:

1. Do you have a licensing agreement with a foreign manufacturer?
2. If not, are you contemplating one?
3. If you have an agreement or contemplate one, what prompted you to consider it?
4. How was (or will) the original contract be made? (Personal visit, Department of Trade & Commerce, foreign agent, other.)
5. What type of license agreement (will be) signed?
   a. Patent
   b. Trademark
   c. Technical assistance
   d. Know-how
6. (a) What products have been (will be) licensed for manufacture?
   (b) In what countries?

7. What difficulties, if any, have been encountered (are contemplated) in servicing the license contract?

8. What has been (will be) the average percent royalty return?

1 - 5%
5 - 10%
over 10%

Participants were also asked to give an approximation of their total sales and percentage of export sales. The final two questions were:

What other methods have been used by your company to remain competitive, or gain entry into, foreign markets? (a) Establishment of a subsidiary, (b) joint - stock ownership of a foreign manufacturer, (c) merger, (d) sub-contracting, (e) price and/or credit adjustments, (f) other.

Do you think licensing will be used increasingly by Canadian manufacturers? If not, why?

Fifty-nine replies, approximately 30%, were returned from the original mailing of 160. Of these, 21 were actively engaged in licensing, eight were contemplating licensing, and the balance had no interest in any sort of license agreement. Most of the latter group were subsidiaries of American companies which had licensing agreements of their own. Licensed products included: special construction cements, stoves, medicines, pens, foundation garments, lighting products, semi-trailer chassis, plastic resins, auto carpets, isotropic instruments and a host of other consumer goods. The U.K. was mentioned as the most frequent licensee country, followed by Australia, New Zealand, France, Argentina, U.S.A. and Mexico. Regionally, Western Europe (including the U.K.) ranked foremost as the best current market for licensing. Latin America and Australia were next. Hong Kong, Iran and South Africa were mentioned as possible locations.

Know-how and technical assistance were the rights most commonly licensed, frequently combined with a patent or trade mark arrangement. Respondents mentioned that there were few difficulties encountered in servicing the contracts. In one instance, poor quality caused a cancellation of the agreement. The most frequent problem mentioned was the delay of local governments making dollar royalty allocations. Two companies mentioned problems of communication and understanding. All expressed satisfaction with their existing agreements.

In reply to the question on royalty returns, 13 companies indicated that they were receiving 1% to 5%; eight from 5% to 10%. The usual rate of return given was 5%.

About two-thirds of the 29 manufacturers engaged in, or contemplating, licensing had sales of $1,000,000 to $10,000,000. By far the largest percentage of the above group indicated that export sales were less than 20% of total sales. In reply to the question: If you have an agreement or contemplate one, what prompted you to consider it? Most respondents said that exchange restrictions and import controls were the main cause. Other factors mentioned were the high cost of Canadian manufacture and lower foreign labour costs. Only two licensors stressed the desire for reciprocal exchange of industrial property rights as being first. All original contracts were made personally either by a trip overseas or by a Canadian visit from the prospective licensee. The Department of Trade & Commerce and foreign agents were used to assist in establishing contacts.

The majority of companies stated that subsidiary operations were the most desirable means of retaining, or gaining entry into, foreign markets. Comments concerning the types of products that could be licensed included "a specified nature", "distinctly Canadian", and "exclusive". In the consumer goods field, trade marks were of greater significance as a licensing vehicle than know-how. Other comments with interesting implications were: "licensing seems to us like a good alternative, but we have not as yet given the matter much consideration", "Canadian manufacturers, not either U.S. or U.K. affiliated, in a position to undertake licensing agreements, are very few in number."

Many points of view were expressed in reply to the question: Do you think licensing will be used increasingly by Canadian manufacturers? The following quotations give some idea of the types of replies received (to protect the interests of the contributors, company names are not used):

> "We feel that where products of a very specialized nature are involved fully protected by patents, licensing for the production of such products in overseas areas under royalty agreements may be looked on favourably by Canadian manufacturers.
>
> Whether or not such licensing arrangements would increase in the years ahead we feel would depend on the development of such products here in our country which could be fully protected under patent and copyright laws."
>
> —Large Food Manufacturer

* * *

> "Not in our field. All goods exported are manufactured in our Canadian plant—no manufacturing license or rights have been granted."
>
> —Specialty Food Manufacturer

"No. Because there are few Canadian manufacturers who are not either U.S.A. or U.K. affiliated who are in a position to undertake licensing arrangements . . . this mainly from a product standpoint. If the pattern of Canadian trade was reversed; i.e., export manufactured and semi-manufactured goods and import raw materials, considerations of licensing arrangements by manufacturers would be of paramount importance."

—Heavy Industrial Goods Manufacturer

* * *

"Yes, But manufacturers must do the research necessary and design and develop Canadian products. If this is done they will find a ready market for licensing agreements."

—Small Lighting Manufacturer

* * *

"No. Canada has a small domestic market and has capacity to produce a great deal more than domestic requirements. Canadian manufacturers would, generally, rather make and sell in the foreign market than license a foreign manufacturer to supply the foreign market."

—Large Industrial Goods Manufacturer

* * *

"In a large number of subsidiary companies, wholly or partially controlled by foreigners, parent company would likely extend license directly. We are finding ourselves priced right out of the export market."

—Large Electrical Manufacturer.

* * *

"It is our thought that joint-stock ownership is probably the best solution. However, medium-small companies like ourselves because of lack of capital are not in a position to immediately take advantage of such an operation which is usually fairly costly. Under a licensing or royalty arrangement, however, funds can be made available in a particular country for eventually setting-up a joint ownership if desired and suitable."

—Construction Materials Distributor

"Yes, particularly in manufactured consumer goods."

—Pharmaceutical Goods Manufacturer

* * *

"Yes, it is the easiest and most profitable way of operating in Foreign Countries."

—Consumer Goods Manufacturer

—Non-food Product

* * *

"Licensing is only possible where a manufacturer has patents—or know-how—that are on the forefront of development. Other countries do not normally look to Canada for new thinking and practice except in certain fields. Where a manufacturer or individual has such commodities they are most likely to sell them by knocking on doors in other countries. This was my experience."

—Industrial Consultant

* * *

"Not if it can be avoided, as most manufacturers rely on export volume to carry a certain load in their plants. The European Common Market, high Canadian labour, transportation etc., might force a change in some areas of manufacture, but would think a subsidiary would be the alternative most desirable."

—Medium-sized Consumer and Industrial Goods Manufacturer

* * *

"We think it quite likely that Canadian manufacturers of unique or distinctively Canadian articles might make increasing use of licenses to manufacture. We do not think that the manufacturers of standard items, such as ourselves, are likely to take much advantage of it. We are, of course, seeing a growing number of cases where Canadian manufacturers are moving their own factories, or branches of them, to Hong Kong, Belgium, Britain, etc., in order to take advantage of low wage rates, and then ship back in to Canada".

—Light Industrial and Consumer Goods Manufacturer

"There will be only a nominal increase in licensing because those who undertake such a plan will be faced with Canadian high-cost manufacturing and price competition from imports."

—Large Industrial Manufacturer

* * *

"Yes, Export countries, becoming better equipped with machinery and experience, and having wages half or less than half those of Canada—export from Canada impossible. Licensing best alternate."

—Heavy Industrial Manufacturer

* * *

"It is difficult to express an opinion as to whether licensing will be used increasingly by Canadian manufacturers, because unfortunately it has been our impression that as a group Canadian manufacturers seem to lack interest in foreign trade as a whole, and consequently in its ramifications including licensing. It could be stated though that licensing *should* be used increasingly by Canadian manufacturers."

—Large Consumer - Industrial Manufacturer

* * *

"We do not know to what extent other Canadian manufacturers will be using this licensing method but with the rising cost of production in Canada, a great many of them will have to take the approach of owning manufacturing units or having some kind of licensing manufacturing with companies already established if they are going to stay competitive and keep their business in some of the world areas. The climate of the Canadian Government is not the best in its help to Canadian manufacturing industry for export and there appears no change on the horizon."

—Heavy Industrial Manufacturer.

* * *

"The companies that have the cash and can negotiate with the government are silly to license another company unless they cannot avoid it. The preliminary negotiations are most crucial, since the local government has more direct control over its own nationals than it does foreigners. However agreements topple with governments, so it is difficult to generalize . . . I cannot overemphasize the importance of being extremely careful in the preparation of plans and study of the 'ground rules' wherever one contemplates setting up subsidiaries. The economic climate in many countries is so changeable, it requires the subtlest imagination to keep abreast of the factors which one is exposed to in the care and feeding of foreign subsidiaries.

In my humble opinion, I do not think many Canadian companies have made much of an effort to develop people for foreign business. Aside from business training, we sorrowfully lack linguistic abilities, and the Canadian mentality is distressingly insular. Most Canadian companies who are in a position to 'go abroad' *are themselves subsidiaries* . . . hence the bulk of the export sales will be handled through the parent wherever practical. One of the biggest of Canada's markets has drifted away from Canada . . . the Commonwealth countries . . . and subsidiaries set up. Canada formerly had these markets only because the tariffs were lower for imports from Canada than the U.S.A. There are no real advantages left for Canadian exports over British and American products, hence the importance of high capacity production facilities in Canada is static. Many Canadian companies find domestic production too costly . . . with the result that some have started subsidiaries elsewhere (the West Indies etc.) to import into Canada. There is a big difference to starting a subsidiary inside the Commonwealth in comparison to, say Brazil or Argentina. It is comprehending this difference that will determine the success or failure of a subsidiary."

—Large Consumer Goods Manufacturer

AN INSTITUTIONAL APPROACH TO LICENSING

Does foreign licensing perform a worthwhile function in the international economy? Such a broad question might quickly have attached to it the label of being "strictly academic." However, some of the ideas and concepts which come out of such an analysis might have practical applications.

Licensing permits the association of two companies for mutual benefit without a large capital investment. For this reason, it could become a useful type of arrangement for small companies wanting to expand their operations into foreign markets. Alexander O. Stanley, in an article in *Dun's Review and Modern Industry,*[3] states some reasons why small companies in the United States are going abroad:

[3]"Small Business Goes International", Alexander O. Stanley, *Dun's Review and Modern Industry,* October, 1958.

1) Bigger profits through foreign sales, lower costs through foreign purchases, and a stronger competitive position through the interchange of ideas.
2) It is easier, cheaper, and faster to get around the world.
3) Communication and banking facilities have grown to accommodate the business man as well as the tourist.
4) Vacations abroad have become more popular.

Perhaps it is not unrealistic to add that foreign association provides a means of fostering international understanding and, provided profits can be made, should not be dropped just because it appears excessively complicated.

Foreign licensing as a means of international association should probably not be entered into under conditions where the only gain to be made is from royalty return. The usual return is so low that other forms of investment are more attractive. In this connection, a question might be asked concerning the value received for the royalty fee. What does the opportunity to license offer the licensee? Why are many European companies pressing to find North Americans who will license their patents, trademarks or know-how? The answer is simple. Licensing provides an opportunity of transporting assets (in the form of knowledge gained through research and experience or goodwill) from one country to another. The licensee can gain the benefits of these assets in exchange for a fee and avoid the heavy outlays in research and promotion that would otherwise be necessary. Considered in this way, a licensing fee of 5% of sales does not seem excessive and would probably be less than comparable outlays for amortized research and promotion expenses. Nationally, it might be justified on the basis that it allows one nation to gain the benefits of the experience of another and, unlike outright copying or patent-stealing, gives a return to the supplier nation for the investment which it has made in producing the asset.

CANADIAN EXPERIENCE IN FOREIGN LICENSING

The results of the survey described earlier combined with careful consideration of the Canadian export situation shows that foreign licensing will interest a relatively small segment of the business community. Of those companies that are involved in export or are otherwise interested, only a few have the types of products or know-how suitable for licensing. Many companies who could license prefer to invest in operating subsidiaries, persumably because they can control their foreign operations better and choose the location of the subsidiary so that dangers of expropriation or other financial complications are minimized. Some companies are reluctant to pass on their ideas to a foreigner for fear of setting up a formidable competitor. Some mistakenly feel that, once the agreement has been signed, there is no longer any necessity to invest in research and development. It is not inconceivable that in this instance the foreign company could eventually take over the domestic.

Most companies expressed satisfaction with licensing agreements once they were operative. Consider the case of the heavy industrial goods producer who reported as follows (firm identity disguised):

> "Our present association began in February of 1956 through an enquiry by a firm in Venezuela for Product A. A few months later their factory manager visited Canada and shortly thereafter we entered into an agreement whereby they would build Product B to our designs under a licensing agreement. From our standpoint and we believe equally so from a standpoint of our licensee the agreement has been profitable.
>
> In general, we supply blueprints, bills of material and any engineering guidance which the licensee requires. The licensee buys material where he desires and fabricates it in his own shop, although we supply a limited number of items which cannot be readily obtained from other sources.
>
> In the original agreement royalty was based on a percentage of sales value but this was found somewhat unwieldy and is now based on a fixed amount per unit sold as determined by the number of pumps purchased for production purposes. In 1956 we sold the licensee a reasonable amount of material and in 1957 volume increased greatly. In 1958 it fell off considerably due to political changes in Venezuela; however, 1959 has shown a satisfactory improvement.
>
> While the original agreement was in regard to Product B, our licensee is now considering the manufacture of C products and has imported a number of them this year in a knocked-down condition which he proposes to assemble and put on the market in the coming months.
>
> Perhaps one of the reasons for success in this undertaking has been the fact that the licensee has an up-to-date plant and competent management.
>
> Generally speaking, the writer feels that any firm manufacturing bulky or heavy equipment might well consider license agreements provided it can find licensees with the proper qualifications."

Foreign licensing might be considered a worthwhile alternative to declining exports for many of the companies described.

WHERE SO MANY FAILED

Our sympathy goes out to Professor V. W. Bladen, Dean of Arts at the University of Toronto, on his appointment to the Royal Commission on the economic problems and prospects of the Canadian automobile industry. It is a one-man commission; Professor Bladen is the man. He is expected to study the present and prospective competitive position of Canadian auto manufacturers in both the domestic and export markets. He is expected to find out how the Canadian industry fares in comparison with auto industries in other countries. Having done this, he is then expected to recommend how management, labor, Parliament and the Government can, together, help the Canadian industry to overcome its present difficulties, and to provide long-term employment for Canadian workers.

There can be no doubt about Professor Bladen's considerable abilities as an economist. However, the automobile industry and the Government—and, for that matter the United Automobile Workers union—have in their employ many able economists. All of the industry and union economists have been at work on the industry's sales and employment problems. They have not found the answers. Most, if not all, of the Government economists have been at work on similar problems in several Canadian industries. They have not found the answers. How can a lone professor succeed where so many experts have failed?

Is the job even one for economists? Canadians are spending more on motor vehicles than ever before —in 1959 they laid out a record $1,540,168,000 this way. The reason the Canadian automobile industry is depressed and Canadian auto workers are unemployed, is not because people are buying fewer cars, or spending less on cars. It is because people are buying fewer Canadian cars; because they are spending less on Canadian cars.

In four years the Canadian product has lost more than 20 per cent of the domestic market to British and European products. In 1956, the overseas imports captured only 8 per cent of Canadian sales; this year they are capturing 29 per cent. Can economists tell the auto industry how to regain its lost customers? Can economists tell it how to produce—and how to sell—cars of the size and a price, a design and a quality, that will compete with the imports? Is not this a job for engineers and salesmen? Is the Bladen Commission really to be taken seriously?

Even if Professor Bladen should prove himself an industrial Hercules; even if he should, single-handed, achieve what the industry's whole management has not; how does the Government intend to implement his recommendations? By forcing them on the present management? By taking over the industry and letting Professor Bladen run it? Or is it perhaps that the Government does not expect Professor Bladen to tell the industry how to compete? Is he perhaps expected only to recommend measures—like subsidies on production and exports; like higher tariffs on imports—that will relieve it of the need to compete?

Toronto *Globe and Mail*

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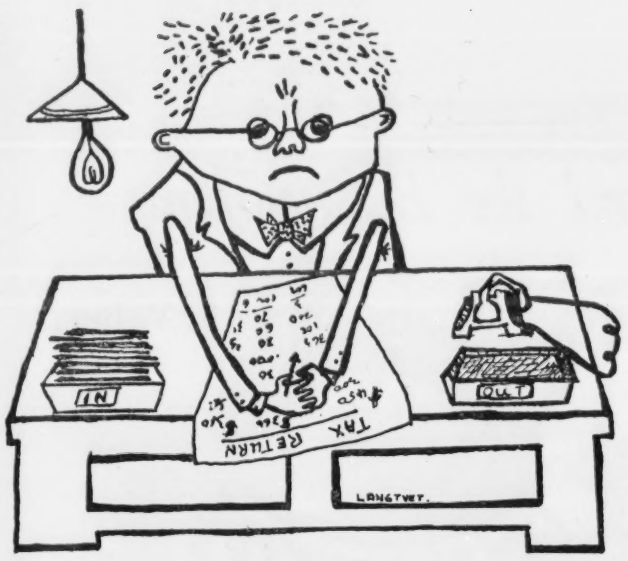
Renown · optina · TECO · Cottage Sweets · Commander · SOLAR
bellefair · La Reine · BULLDOG · Glider · Mountie · Bonnie Brae

Did You Know -

—that the funds invested by the life insurance companies provide one of the most important sources of capital funds for the Canadian economy?

The CANADA LIFE Assurance Company



Canadian Taxation and the Businessman

K. W. LEMON, F.C.A.

Since 1949 Canadian fiscal policy has provided for a lower average rate of income tax on the earnings of smaller companies than that applied to the earnings of larger, more profitable corporations. This policy has been carried into effect by applying a substantially lower rate of tax to the first $25,000 (previously $10,000 and $20,000), of each corporation's earnings. The balance of corporate earnings has been taxed throughout the period at very much higher rates.

From the inception of this policy, the Income Tax Act has included safeguards to prevent a corporation from dividing up its business into several smaller corporate entities and thus enjoying the benefit of the lower tax rate on several amounts of $25,000. This has been accomplished by providing that a group of "associated companies" are entitled to have only one amount of $25,000 taxed at the lower rate.

Up to the present time, the test of association between companies has been based on the ownership of common shares. Companies have been associated if one owned 70% or more of the common stock of another or if 70% or more of the common stock of each was owned by one person. This test of association was probably not unreasonable although in many cases it applied a significant tax penalty against shareholders who held only minority interests in companies which became associated as a result of the holdings of a majority shareholder.

In the 1960 amendments to the Income Tax Act, the existing rules for determining associated status based on ownership of 70% of common shares have been replaced by a new set of rules based on voting control. In the future corporations will be considered to be associated if one controls the other or if two or more are controlled by the same person or *group of persons.*

It is important to note that the new rules do not apply until the 1961 taxation year. Thus corporations which are not now asociated but would become so under the new rules will have until December 31, 1960 to take such steps as may be appropriate to avoid associated company status.

The new rules have been designed presumably to block the actions of a minority of taxpayers who have taken advantage of the loopholes which existed in the old legislation. The measures taken to prevent this comparatively minor form of tax avoidance, however, will result in a substantial increase in the number of minority shareholders who will be penalized through no fault of their own. In the future the holders of a substantial minority interest in a small company will find their share of corporate profits subject to higher rates of tax merely because 51% of the voting shares of the company happen to be held by a person or group of persons who control another company.

The new concept of association through control of more than one company by a group of persons could be equally serious as, if this rule is interpreted and applied strictly, it would result in the association of many corporations in circumstances which could hardly have been contemplated by Parliament when the legislation was enacted. The results which will develop as this new legislation is applied in practice will be watched with interest by the Canadian businessman.

Canadian Law and the Businessman

PETER V. V. BETTS

DOWER AND THE MYSTERIOUS DEED OF USES

The businessman can perhaps be excused for displaying mild irritation at certain aspects of the law. Divorce is a good example and so is dower. Both give rise to fiction. The former is condemned by the Courts, while the legal fiction which avoids the operation of the law of dower was invented and is to-day enforced by the Courts themselves. The law of dower is very ancient and comes to us through many hundreds of years of English common law.

In essence, the proposition is that upon the death of a married man his widow has a life interest in one-third of the lands which the deceased husband owned at any time during the marriage. Some jurisdictions have made the common law rule a little more workable by providing that dower shall only apply to those lands owned by the husband at his death. This is not so in Ontario. The obvious result is that a man might marry in 1960; purchase land in 1962; sell it in 1965 and die in 1980. His widow might then claim from the purchaser her right to dower in that land. That is, she could compel one-third of the property to be allotted to her and live thereon rent free for the rest of her life. Alternately, a money value could be placed on this and paid in cash to the widow by the purchaser.

As a matter of practice, of course, a prudent purchaser in the example just cited would insist that the wife at the time of the sale release her dower. This could be accomplished by a separate document, but is more frequently incorporated in the Deed executed by the husband wherein the wife joins to bar her dower. Having done so, she has no further interest in the property and we can forget about dower so far as this piece of land is concerned.

Businessmen, however, and particularly land developers, do not always care to bring their wives into every business venture. This frame of mind has probably existed for many years going back to the development of the "Deed to Uses", or as it might more properly be described, a "Deed in Trust" where the same person is both Trustee and beneficiary. Let us suppose you wish to buy land and wish to feel free to sell it without the concurrence of your wife. You could have "T", a Trustee, buy it and hold it for you and then sell it on your instructions. The trouble has been that down through the years "T" has not always been honest and lately his fees have become quite significant. Assuming, however, the perfect Trustee (one who was scrupulously honest and prepared to work for nothing) the scheme would appear to be perfect, provided the Court could be induced to overlook the fact that you were the true owner. The Court did so more than 100 years ago and held that dower did not attach to property held on trust for another. The problem then resolved itself into a search for the perfect Trustee. It was not long until some owner evolved the brilliant idea that he himself would be the ideal Trustee. Let us call him (the owner) "O". "Why not", he suggested, "have the lands conveyed to me -O- in trust for "O"? He then argued (quite speciously you will say) that since formerly land held by "T" in trust was not subject to dower, neither should land held by "O" in trust be subject to dower. In both cases he had been the beneficial owner. The only difference was that in this case he was also the Trustee. This sort of argument could only fool a lawyer. The reverence for precedent being what it was, however, the Courts were reluctant to interfere with their previous decisions and were unable to see that the identity of the Trustee made any difference. The ruse thereupon won the blessing of the Courts and the proposition established that there was no dower in trust property even where the owner and the Trustee were one and the same person. In those early days a "trust" was known as a "use" hence the expression "a Deed to Uses" where we might more properly say "a Deed in Trust".

There are other ways of defeating dower, of course, such as having the land held by a Private

Continued on page 189

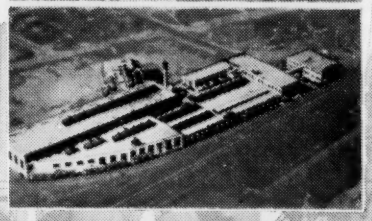
YEARS OF PROGRESS

1910 - 1960

Hamilton Works

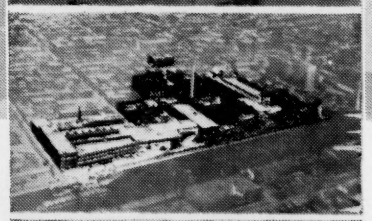
Canada Works

Parkdale Works



Swansea Works

Brantford Works



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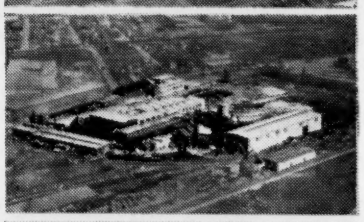
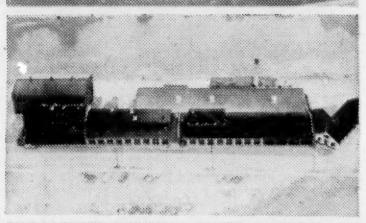
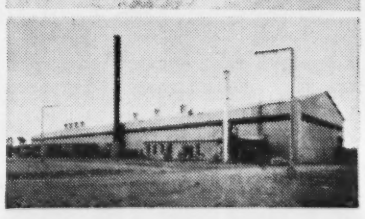


Dominion Works

St. Henry Works



Gananoque Works



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BOOKS FOR THE BUSINESSMAN

Reviewed in this Issue		*Reviewer*
SAME THEORIES OF ORGANIZATION	Albert H. Rubenstein and C. J. Huberstroh	*Craig Lundberg*
A CHANGING AMERICA AT WORK AND PLAY	A. Wilbert Zelomek	*D. S. R. Leighton*
WORK MANAGEMENT	Guy C. Close	*Michiel Leenders*
PSYCHOLOGY IN BUSINESS	Leslie Beach and Elon Clark	*A. Mikalachki*

SOME THEORIES OF ORGANIZATION

Edited by Albert H. Rubenstein and C. J. Huberstroh. The Dorsey Press, Inc. and Richard D. Irwin, Inc. 1960, 422pp. $7.95.

The study of organization is perhaps just now leaving that phase which the editors term "arm chair theorizing and casual empiricism." The reasons for advancement in the field seem to hinge on two factors: a growing concern with more systematic and rigorous research methods; and a growing focus on organizational behaviour, that is, on the "processes" of organizational functioning. Notable recent books have provided landmarks in the significant tide of new literature on organizations. Indicative are March and Simon's *Organizations* which stands out, and such books edited by M. Haire, *Modern Organization Theory* or R. Adams and J. Preiss, *Human Organization Research.*

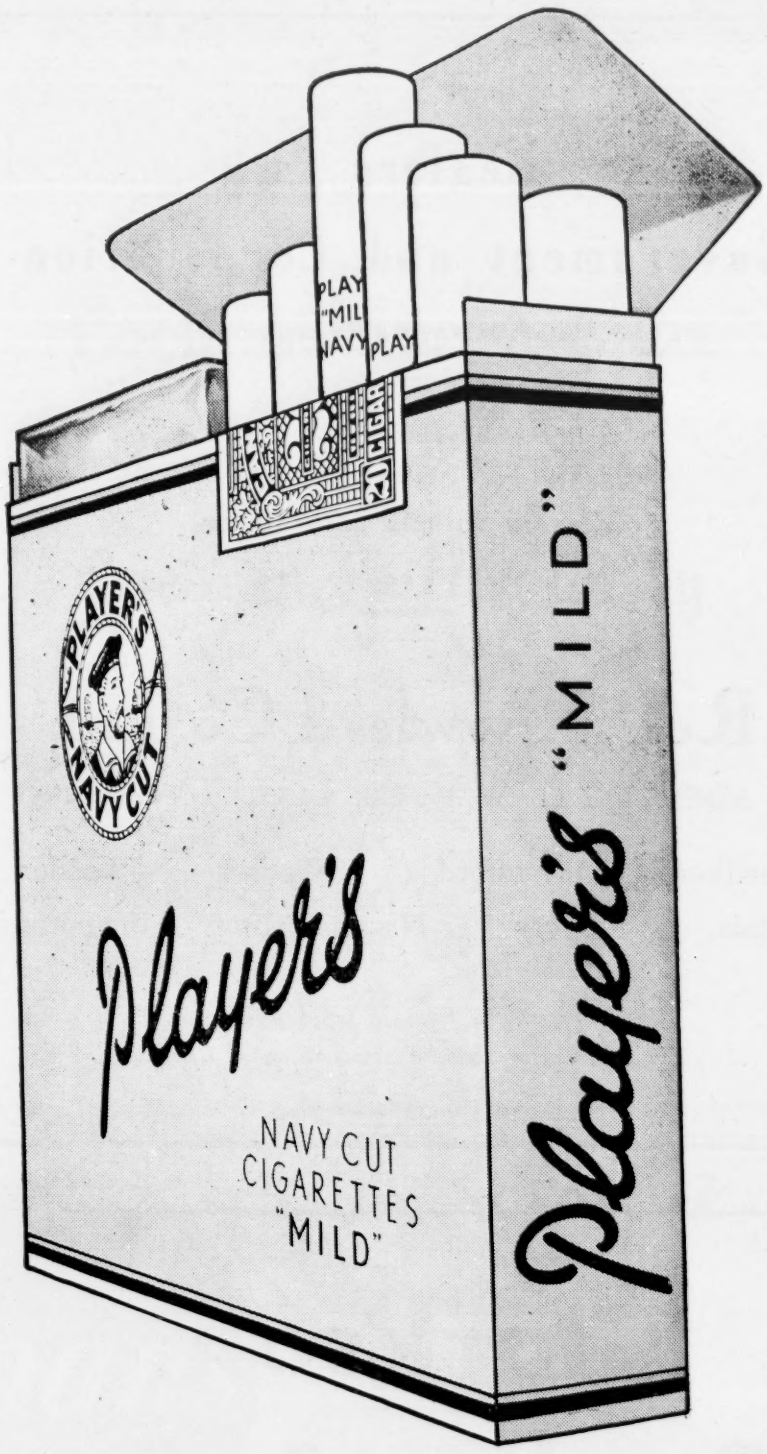
Basic to progress in the study of organizations is the continuing effort to integrate and synthesize the best of the good current work. The contribution of *Some Theories of Organization* lies in this vein. Rubenstein and Huberstroh have compiled 38 articles under the following headings: The Nature of Organization Theory; Organizational Structure and Process; Leadership and Morale; Communication; Control and Evaluation; Decision Making; and Research Techniques. The editors introduce each section with appropriate comments, showing unusual perseverence to their announced emphasis on viewing organization as a *scientific* field and on the process of organizational research itself. To illustrate the value of these introductory sections this reviewer mentions the careful disinction made in the first introducton between a *model,* which " . . . is a system or object that stands in place of another, usually more complicated system or object," and a *theory,* whose earmarks " . . . seem to be that it (1) has empirical reference; (2) contains logical interconnections with other theories; and (3) admits the possibility of rejection." Really beside the point here but interesting is that such a neat distinction suggests the title of the book to be changed to "Some Models of Organization."

Books for Businessmen — cont.

The articles included are diverse in style, content and subject matter. Some articles, for example D. McGregor's "The Human Side of Enterprise," are comprehensible by every reader, though many readers while agreeing with the "feel" the article has, may question the substantiation. Other articles are more technical and more difficult. Again to select an illustrative article arbitrarily, Ward Edwards' "The Theory of Decision Making," is a complex survey combining the special languages of psychology, economics and statistics.

The Edwards' article leads off the section on decision-making, certainly a subject at the forefront of organizational and administrative study today. Rubenstein and Huberstroh are to be complimented on their understanding of the main issues and current research interests in contemporary organization study. While their book was designed primarily for use in graduate courses, the healthy inclusion of many relatively non-technical selections offers provocative reading for practitioners as well. Much of the benefit of the book will come from an increased sensitivity to organizational phenomena when the reader applies the new concepts and ways of thinking which the book suggests. The attention to research method provided by this book should leave the conscientious reader better able to assess all the literature on organizations. In sum, *Some Theories of Organization* provides much food for thought; it is the kind of a book that made the reviewer often pause, turn back to a previous sentence, compare statements, and then feel both chagrined at not having thought of it just that way before and pleased that a new perspective had been acquired.

—Craig Lundberg,
Assistant Professor, U.W.O.



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A CHANGING AMERICA AT WORK AND PLAY

by A. Wilbert Zelomek, John Wiley and Sons, Inc., New York, 1959, 181 pp. $4.50

It is now almost 10 years since the publication of the first of the *Fortune* series on *The Changing American Market.* These articles, gathered together in book form and published in 1955, clearly and vividly illustrated the tremendous social and economic changes that had taken place in the U.S. since the end of World War II, and highlighted the implications of these changes for business. The impact of the *Fortune* articles in the marketing world was nothing less than tremendous.

Now we have, in Zelomek's *A Changing America,* a fitting follow-up to the *Fortune* book. Zelomek is a keen observer with a nice sense of perspective, and he does a masterly job in drawing out basic trends from a great mass of detailed evidence. More than this, he appears to be able to look calmly and dispassionately at such social phenomena as the growth of suburbia, increased leisure time, and modern cultural activities without the superior sneer that seems to characterize most of today's social commentaries. Zelomek's memory is longer than most, and he puts things in proper perspective by examining some of the real advances that have taken place in the evolution to today's society.

The orientation of the book, and the data used, are definitely American. But although Zelomek is writing about the U.S., virtually every trend that he highlights has its parallel in Canada too. His conclusions are thus completely pertinent to our own situation, and should be none the less useful for Canadian businessmen.

continued on next page

His book is divided into seven sections, in which he takes turns examining modern man, modern woman, automation, leisure, culture, suburbia, and service. In the process, he presents a great many interesting and little-known statistics regarding the changes in our way of life. For example, did you know that:

- There has been a slow decline in the ratio of men to women; where we men had a 104 to 100 edge at the turn of the cenutry, today we are only 98 to 100.

- Our life expectancy has increased from 48 years to 70 years since 1900.

- People are marrying younger; average ages today are bridegroom 23, bride 20, compared to 27 and 22 at the turn of the century.

- In five years between 1950 and 1956, 156 million people changed their place of residence in the U.S.—a total almost equal to the entire population.

- Approximately 70% of all leisure time is spent at home.

- Employment in the service industries (in the U.S.) exceeds employment in manufacturing, contract construction and mining combined. Nearly 60% of the nonagricultural labor force is employed in service industries.

These are a few of the many data Zelomek draws on in his book. At the same time, *A Changing America* is not oppressively statistical. In fact one of its real strengths is its eminent readability. On all counts, this comes close to being a "must" book in the library of every thinking businessman.

D. S. R. Leighton,

Associate Professor, U.W.O

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WORK MANAGEMENT

by Guy C. Close, John Wiley & Sons Publishers, 1960.

Author Close has attempted (and indeed succeeded) to explain and develop work improvement ideas from the basic principles of scientific management. This makes his book attractive to all those with little or no background experience in work improvement and with a desire to learn the fundamentals.

After an excellent introduction of the history of scientific management, the questioning attitude of the work improvement practitioner is explained. Areas for improvement and the cost picture are next discussed. The use of process charts and diagrams as tools of regarding all details is well illustrated. Work sampling and time balancing tools are basically treated, as are the principles for motion improvement. An interesting chapter, although short, on creativity stresses the need "to strengthen our ingenuity and to sharpen our curiosity." That work improvement applies to office procedure is shown in another short chapter. The final part of the book deals with the questions: "Is it really an improvement?" and "How can an improvement be installed?" Human motivation has been stressed as the major problem of installation.

The author has succeeded in supplying a basic text stressing the

continued on next page

principles of work improvement. He has given good illustrations and industrial examples throughout. This book will not make anyone a work improvement expert; it does provide a good solid base from which to start. In addition, author Close has the admirable ability to write clearly, intelligibly, and occasionally humorously, with the result that his "Work Improvement" is very easy to read. This fact, so important in a basic text, coupled with the good treatment of the fundamentals should make this book attractive to anyone interested in work improvement.

Michill Leenders,
Instructor, U.W.O.

PSYCHOLOGY IN BUSINESS

by Leslie Beach and Elon L. Clark. McGraw-Hill Book Company, Inc., New York. 1959. 290 pp., $5.75.

The authors of *Psychology in Business* outlined three main objectives in preparing this text—"(1) to aid the student to understand psychological principles, (2) to help the student apply these principles to job performance, and (3) to assist the student in achieving more satisfying relationships in all phases of everyday living." The first objective is dealt with in the first part of the text which defines and elaborates on such fundamental concepts as individual differences, intelligence, motivation and frustrations, emotions, learning and attitudes.

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FROM COAST TO COAST

Books for Businessmen — cont.

The latter two objectives are dealt with in the second part of the text which delineates the application of basic psychological principles to self-understanding, communications, improving relationships with employees and customers, and home and community adjustment.

Apparently, the authors did not intend to go to any depts with these fundamental psychological concepts and their application. Consequently the text reflects a very superficial, cursory elaboration of these concepts and their application. This is the type of text that one would expect for an introductory course in business psychology. According to the authors' statement in the Foreword, this was their intention.

One of the quarrels I have with this oversimplified presentation is that it tends to condition the reader (or student) to think in unidimensional, cause-and-effect, terms—that is to say, looking at emotions independently from individual differences, intelligence, motivation frustrations, etcetera. I don't mean that one should necessarily look at all these concepts at once; for learning and comprehension purposes this would be impractical. However, the authors could have included a chapter on the relation of the concepts, consequently better describing the multi-dimensionalty of any individual. The other quarrel I have with the text is related to the first, and deals with the second part of the book. In this part, the application of psychological concepts, the authors offer "tips" on improving personal efficiency on and off the job, improving personal contacts, etc.

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Books for Businessmen — cont.

As stated earlier, each individual is a complex character of multi-dimensions and manifesting needs peculiar to himself. It appears fruitless to me to list a set of general principles which would assist a particular individual with his particular problem. I should rather think that these "tips" or "techniques" would be more anxiety-creating than productive for the individual and the person with whom he comes in contact.

This book is recommended for the reader who has little or no sophistication in psychology and its application to business. As an introduction to the relationship of business and psychology, the text is functional. It would be hoped that the reader would follow up this introduction at a more sophisticated level.

Instructor, U.W.O.
A. Mikalachki,

Canadian Law and the Businessman

Company, and indeed many of the States of the Union and some of the Provinces of Canada have to some extent abolished or abrogated the doctrine of dower in favour of Homestead Legislation or restrictions on testamentary power. Any attempt to change the law in Ontario has always met with a storm of protest from various Women's Organizations (although, as must be obvious, the present law is unsatisfactory inasmuch as the protection given to the wife is illusory and can be defeated at will by the husband if he has the means to seek competent legal advice. The result is a trap for the unwary. The law of dower is long overdue for a complete overhaul.

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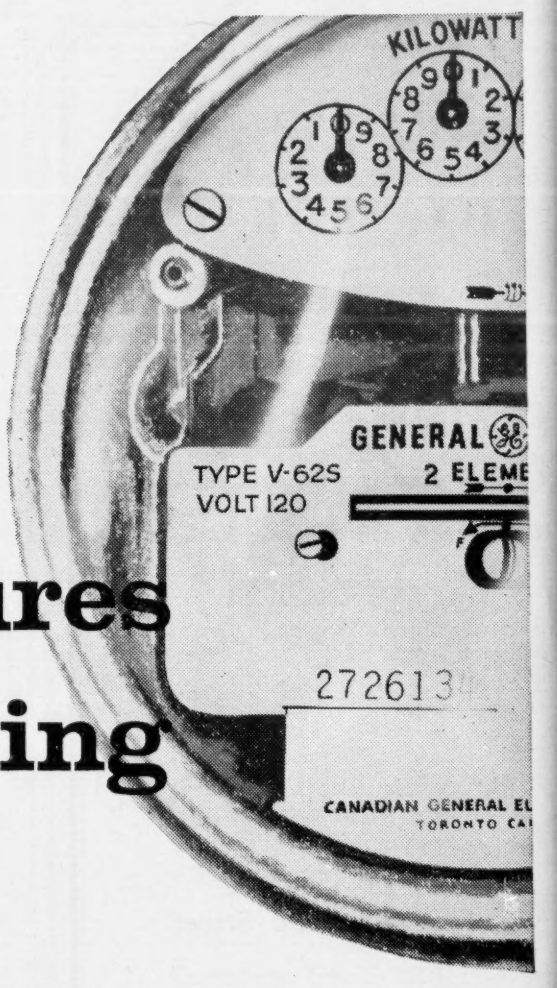

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